Nos. 17,838 and 17,839

UNITED STATES

COURT OF APPEALS

FOR THE NINTH CIRCUIT

W. VAUGHAN,
Petitioner,

vs.

MISIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 17838

W. VAUGHAN,
Petitioner,

vs.

MISIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 17839

BRIEF OF PETITIONER P. W. VAUGHAN

PETITION TO REVIEW A DECISION OF
THE TAX COURT OF THE UNITED STATES

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FRANK H. SCHMID, CLERK

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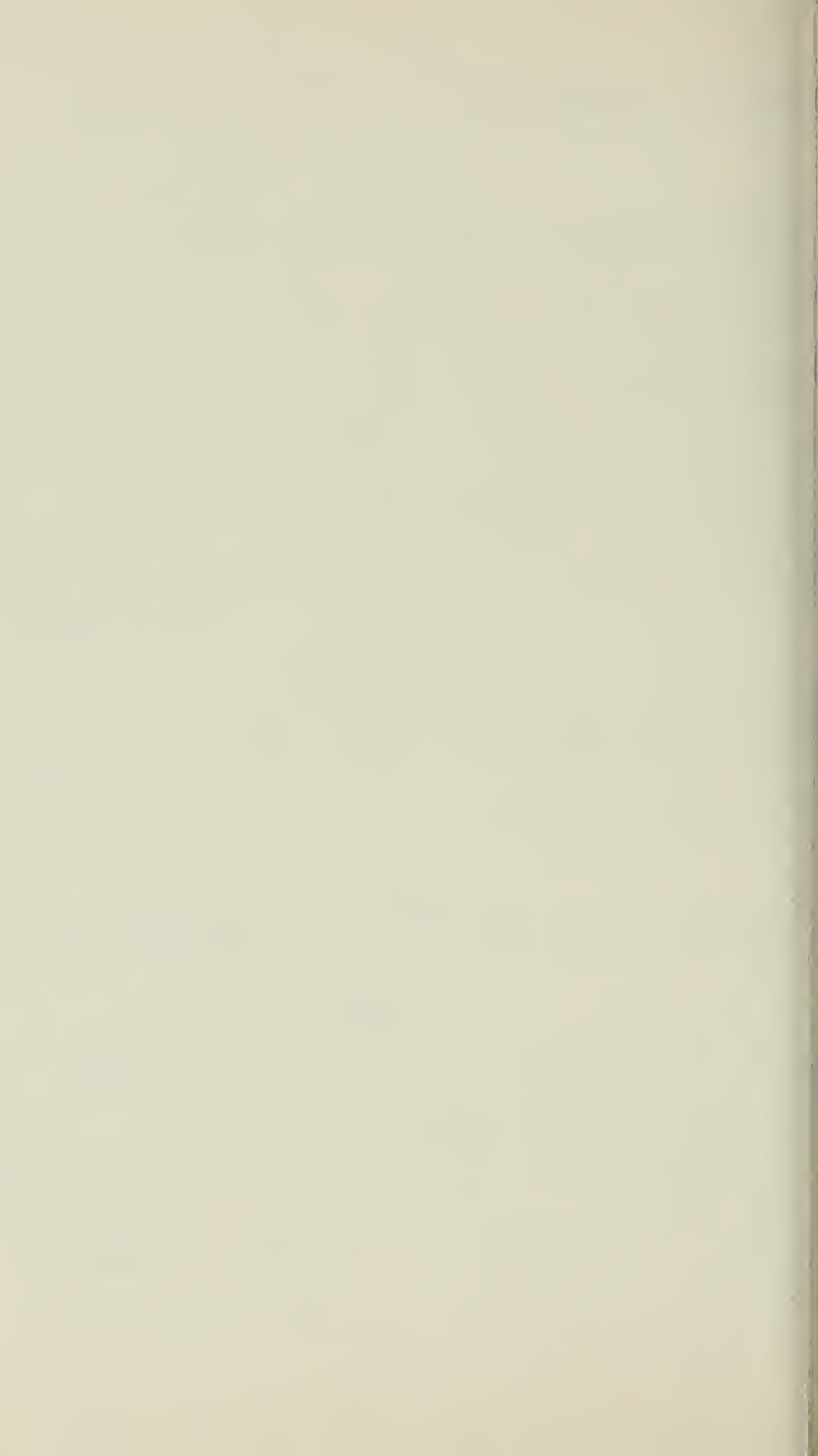

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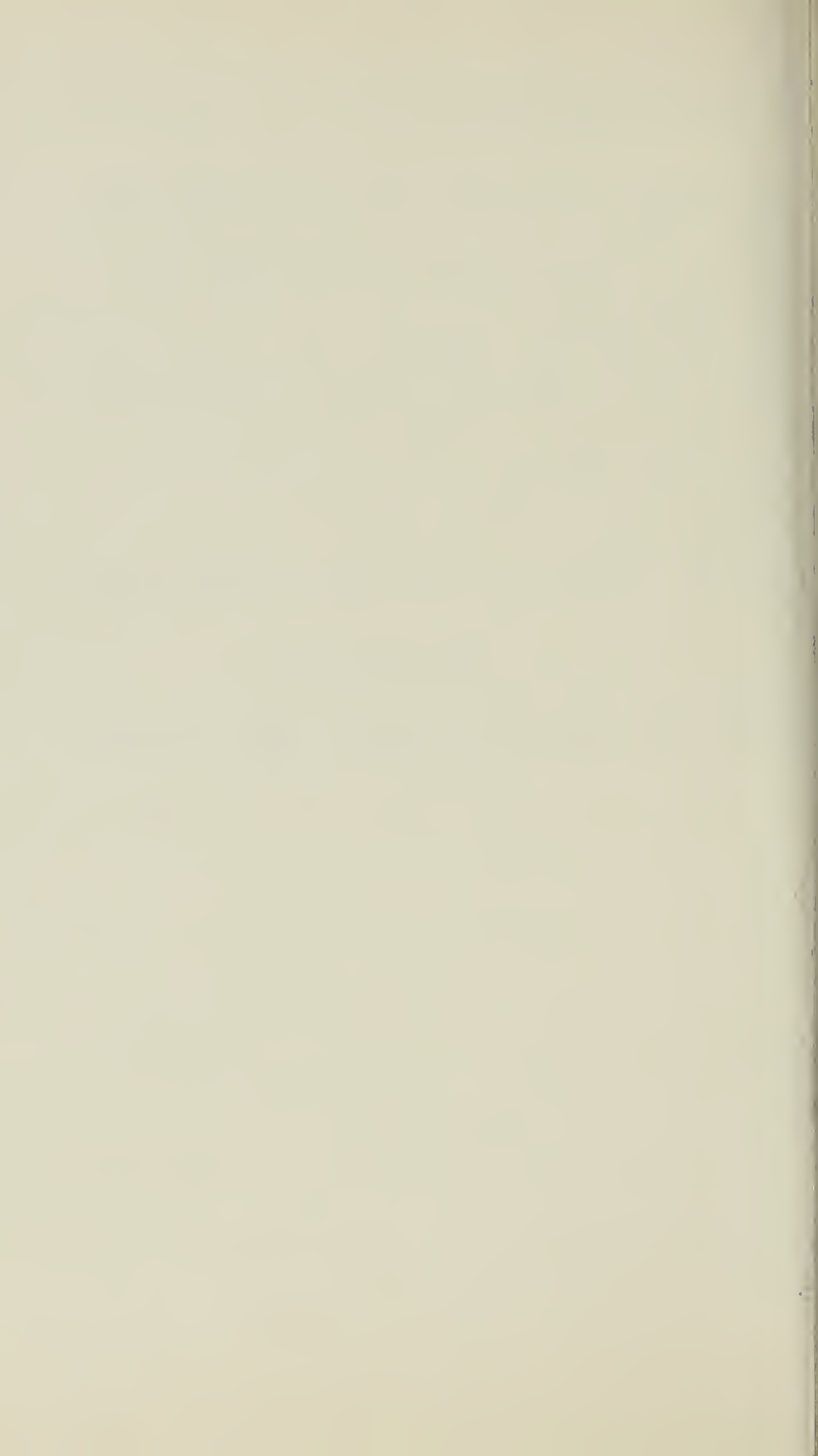

UNITED STATES

COURT OF APPEALS

FOR THE NINTH CIRCUIT

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W. VAUGHAN, Petitioner, vs. MISSIONER OF INTERNAL REVENUE, Respondent.	Docket No. 17839

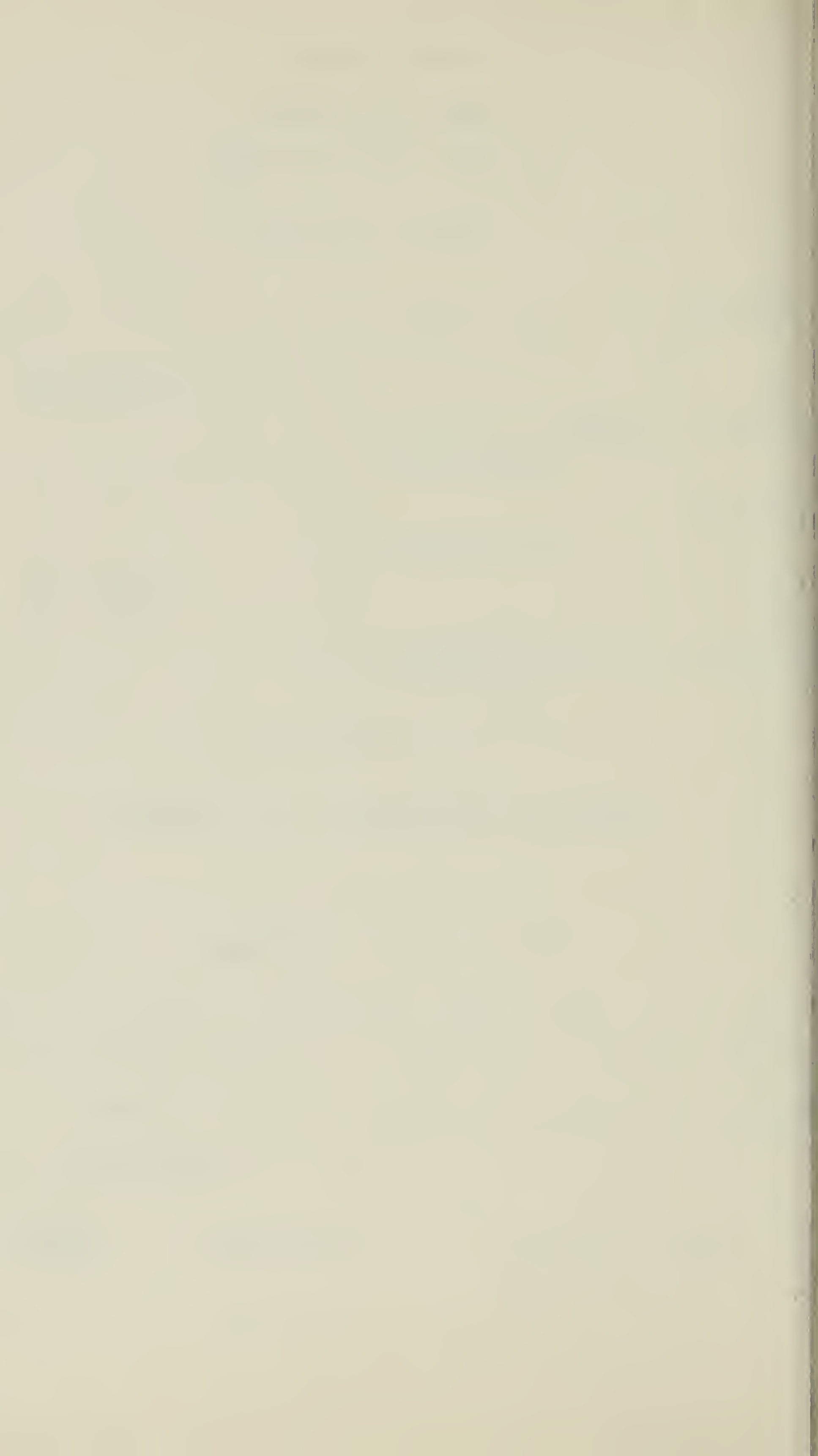
BRIEF OF PETITIONER P. W. VAUGHAN

JURISDICTIONAL STATEMENT

This is an appeal from the decision of the Tax Court of the ed States entered on October 5, 1961 determining deficiencies overpayments in Federal income taxes as follows:

	Deficiency	
Overassessment	Income Tax	Addition to Tax §293(a),1939 Code
($678.36)		
	$ 12.39	$ 0.62
($ 89.84)		
	771.73	38.59

from a decision entered on October 4, 1961 determining



ciencies as follows:

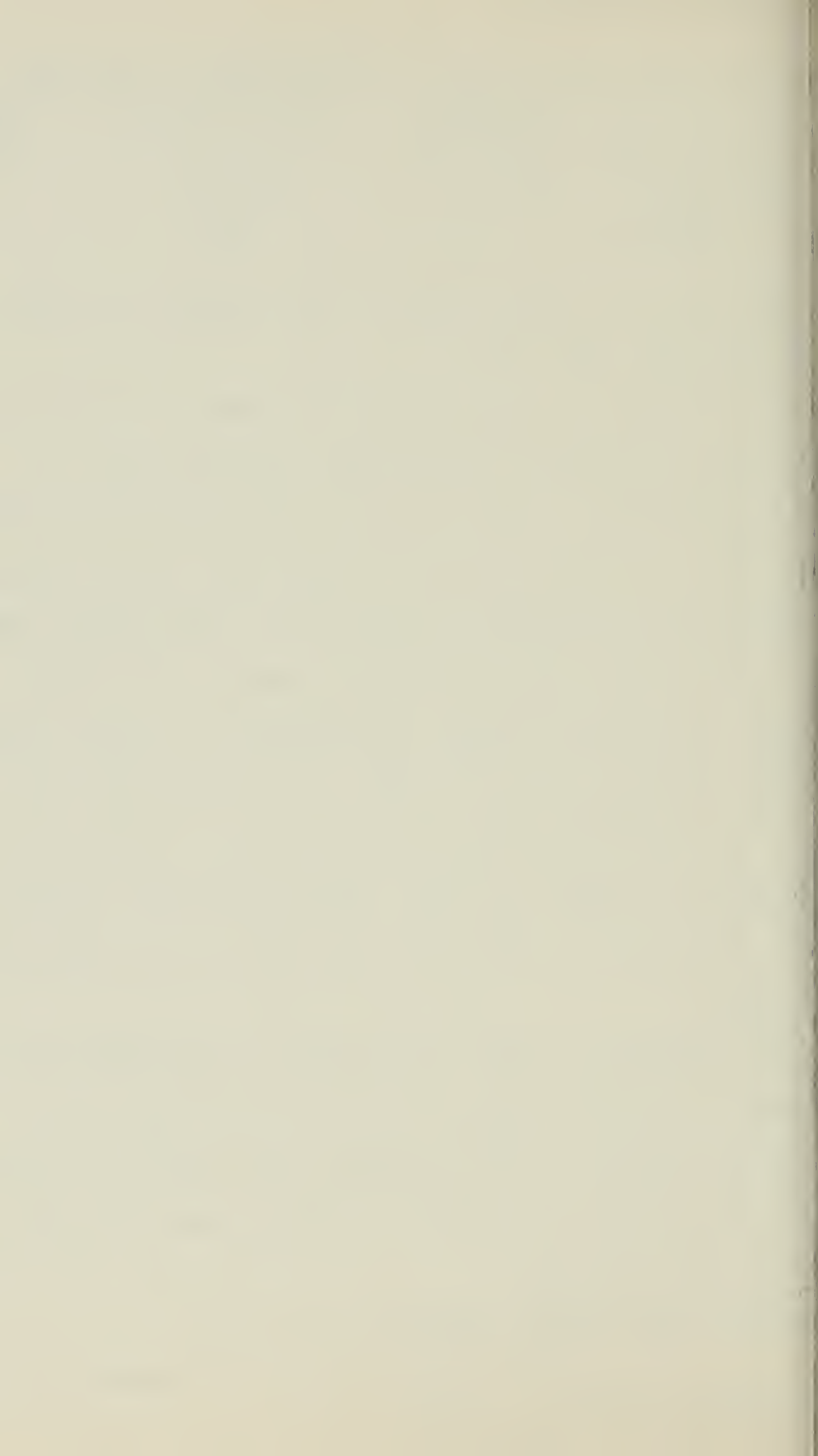
		Deficiency		
		Additions to the Tax		
	Income Tax	§293(a), 1939 Code	§294(d)(1)(A), 1939 Code	§294(d)(2), 1939 Code
5	$5,677.08	$283.85	$904.97	None
5	118.95	6.46	82.69	None
5	144.00	7.20	--	$8.64

The years in controversy on this appeal are 1948, 1949, 5 and 1951 (R. 466, 475).

On December 29, 1954 respondent issued a statutory notice eficiency of personal income tax liability to P. W. Vaughan eafter referred to as P. W.) for the years 1947, 1948, 1949 1950 (R. 9). A petition was filed with the Tax Court of the ed States by petitioner on March 28, 1955, Docket No. 57164 4). On June 19, 1957 respondent issued a statutory notice of ciency of personal income tax liability to petitioner for the s 1951, 1952 and 1953 (R. 43). A petition was filed with the Court of the United States by petitioner on September 16, , Docket No. 69942 (R. 36). Jurisdiction is conferred on the Court by Sections 7442, 6213 and 6214 of the Internal Revenue of 1954.

The Findings of Fact and Opinion of the Tax Court in tioners' cases and the following related cases that were conlated for trial in the Tax Court, and which have been consoli-d in this Court for purposes of this appeal (R. 2), was filed ay 24, 1961 (R. 430).

. VAUGHAN and MATTIE VAUGHAN, Petitioners, v. ISSIONER OF INTERNAL REVENUE, Respondent.	)	Docket No. 17,823



OD C. VAUGHAN,
Petitioner,
v.
MISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 17,836

OD C. and KATHERINE D. VAUGHAN,
Petitioners,
v.
MISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 17,837

. VAUGHAN & MATTIE E. VAUGHAN,
Petitioners,
v.
MISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 17,840

OD C. and KATHRYN L. VAUGHAN,
Petitioners,
v.
MISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 17,841

This Court approved the joint motion of the parties that lof the cases be considered on the record of the cases of this ttioner (R. 3).

The decisions of the Tax Court for the years 1947 through ;, and 1951 through 1953, were entered on October 5, 1961 and tber 4, 1961, respectively (R. 466, 475). Petitions for review aid decisions by this Court were filed December 29, 1961 .482, 502). Jurisdiction is conferred on this Court by Sections : and 7483, Internal Revenue Code of 1954.

STATEMENT OF THE CASE

Petitioner was a partner in Vaughan Brothers, a partnership, eafter referred to as Vaughan) for the years 1948, 1949, 1950 1951. He owned a 25% interest therein and the other partners his father F. C. Vaughan (hereafter referred to as F. C.) a 25% interest, and his brother Floyd Vaughan (hereafter

fered to as Floyd) who had a 50% interest (R. 126). Commencing
940 Vaughan purchased a ranch at Bruneau, Idaho and moved a
rd of approximately 1,000 female Hereford range cattle from
eon to the ranch (R. 127, 128, 266). From the spring of 1940
to 1945 the partnership almost doubled the number of female
tle on the operation (R. 266).

The headquarters ranch was at Bruneau and contained roughly
00 acres. The summer headquarters ranch owned by the partner-
ip was at Battle Creek, about fifty miles south of Bruneau, and
ntained about 3,600 acres. In addition to the deeded land owned
ughan at Bruneau and Battle Creek, they held grazing rights
om the state and federal governments on about 250,000 acres of
nd. The land started at Bruneau and continued south nearly to
e Nevada border and spread out over 25-50 miles east and west at
e southern most portion. The country was rough and inaccessible.
e ranch was classified as a desert open range operation as
fferentiated from an irrigated pasture or fenced range opera-
on. The ranch and leased range capacity during the years under
view was 2100 count cattle. Count cattle include all cattle
cept those less than six months old at the time they are turned
to on the range in the spring (R. 129-138).

In 1945 Vaughan had 2100 count cattle on hand. In May,
4 Vaughan contracted to sell the ranch, all range rights, and
e cattle. The vendees took over operation of the ranch, sold
m 850 to 900 head of weaners and mature female animals (R. 138),
t because of difficulties in securing financing, rescinded the
rchase, with the partnership's consent, and returned the ranch,

e rights, and remaining portion of the herd to the partner-
in October, 1945 (R. 433).

On or about April 1, 1946 Vaughan sold the ranch, range-
, and range rights to Milford J. Vaught (hereinafter referred
s Milford)(R. 139). Milford was unable and unwilling to meet
han's price for the cattle (R. 139, 140, 410). On or about
15, 1946 Milford and Vaughan entered into an agreement for
operation of the cattle herd owned by Vaughan on Milford's
. The agreement was denominated a "lease" agreement and pro-
d that Milford was to furnish the feed, salt, management,
r, and pay all expenses, other than certain range fees and
s, necessary for the operation of the cattle herd as a unit.
xchange for the material and services provided by Milford he
to receive one-half of the sales proceeds from the sale of
cattle sold during the five-year period of the agreement and
half of the surplus of the cattle, after replacement of the
in like kind and numbers as received by him in April, 1946.
agreement provided that Vaughan was the owner of all of the
le and any increase during the term of the agreement (R. 78-
inclusive, 140, 337, 338). The cattle delivered to Milford
r the contract were:

790	range cows
306	heifers coming 2 years old
102	weaner calves
128	heifers
156	sucking calves
38	range bulls
1,520	total (R. 89)

he 1,520 cattle delivered to Milford all were count cattle
ept the 156 sucking calves, making a total of count cattle of

,34 or roughly two-thirds of the ranch capacity. The agreement isfor a period of five years terminating in 1951. All of the itle and all of the increase were, under the terms of the con-'at, owned by Vaughan and branded with Vaughan's brand (R. 78-88,)3 284 285).

The operation of the ranch and cattle herd under Milford ırng the years in question was in substantially the same manner 'perated by Vaughan in prior years (R. 277). All of the cattle ud be turned out on the range about March 15, except the bulls id "calvy" cows and heifers. After the calves were born the calf id its mother were turned out. On May 1 of each year the herd ıls were turned out. The gestation period of a calf is nine nhs. The herd bulls were isolated during March and April to ent calf births in the bad months of December and January. s of the calves were born in February and March, and a smaller nber of calves arrived in the fall. All of the cows, heifers, aers and calves were run with the bulls as one breeding herd d in the production of beef (R. 277, 320, 321, 436, 437).

The principal commodity raised for sale were steers. Good nal husbandry also required that certain cows and heifers be led out of the herd for various reasons and sold. The calf ndup occurred in June when the calves were branded and other-e attended to as required (R. 341, 342). In late August or ptember the beef roundup was accomplished. At this time all of steers to be sold were gathered as were the cows and heifers be culled from the herd and sold (R. 325, 326, 327).

In addition to the steers and culled cows and heifers sold

948, 1949 and 1950, Milford sold other heifers from the herd urnish sufficient funds for him to continue his operations dr the contract (R.289, 290, 292). The number, weight and age he heifers sold were as follows:

Date		Number	Average	Age (In Months)	
a	Month	Sold	Weight	Over	Not Over
[illegible]	Sept.	133	757	24	28
[illegible]	Aug.	135	842	24	36
	Aug.	1	*	*	*
[illegible]	Sept.	94	692	18	24
	Sept.	1	450	12	15
	*	1	*	*	*
[illegible]	*	206	612	15	18
	Dec.	1	375	10	12
[illegible]	*	89	562	14	18
	*	99	703	18	24
	*	53	453	12	15
	Sept.	1	645	18	22
	Sept.	1	620	17	20
	Sept.	2	740	24	28
	Total	817			

* Not shown by record (R. 442)

Milford faithfully performed under the contract and eived as his compensation one-half of the proceeds of all nals sold during the term of the contract. The selection of animals to be sold each year was made by Milford and F. C. or Floyd (R. 159).

The contract expired by its terms on April 1, 1951 (R.82). several years prior to that time Vaughan searched unsuccess- ly for adequate ranch facilities that could be purchased for operation of the cattle herd. As a consequence Vaughan empted to arrange with Milford to continue caring for part of

herd but they were unable to reach any agreement (R. 443).
han, lacking adequate ranch facilities, was therefore required
ell a substantial part of the breeding herd at the time the
was returned in 1951.

The accounting under the contract was commenced in January,
when the cattle were separated and Vaughan removed part of
to Oregon at that time. Some of the cattle were sold to
ford in January (R. 311-319, inclusive). The final accounting
sales to Milford were accomplished in March of 1951. Part
he breeding herd that Vaughan took to Oregon was sold in 1951.

The sales to Milford were as follows:

attle[a]	Age From	Age To	Total Price[b]
cows	6 yrs.	10 yrs.	$ 50,000.00
steers	(c)	(c)	2,400.00
suckers[d]	1 day	14 mos.	1,150.00
weaners (mixed)[e]	12 mos.	18 mos.	51,000.00
bulls	2 yrs.	8 yrs.	6,600.00
cows	4 yrs.	8 yrs.	41,250.00
heifers	20 mos.	24 mos.	11,250.00
Total			$163,650.00

a/ Disposition of 7 cows, apparently to Milford, and the price paid, if any, is not shown of record.

b/ Includes an unspecified amount paid for the dash running "M" brand.

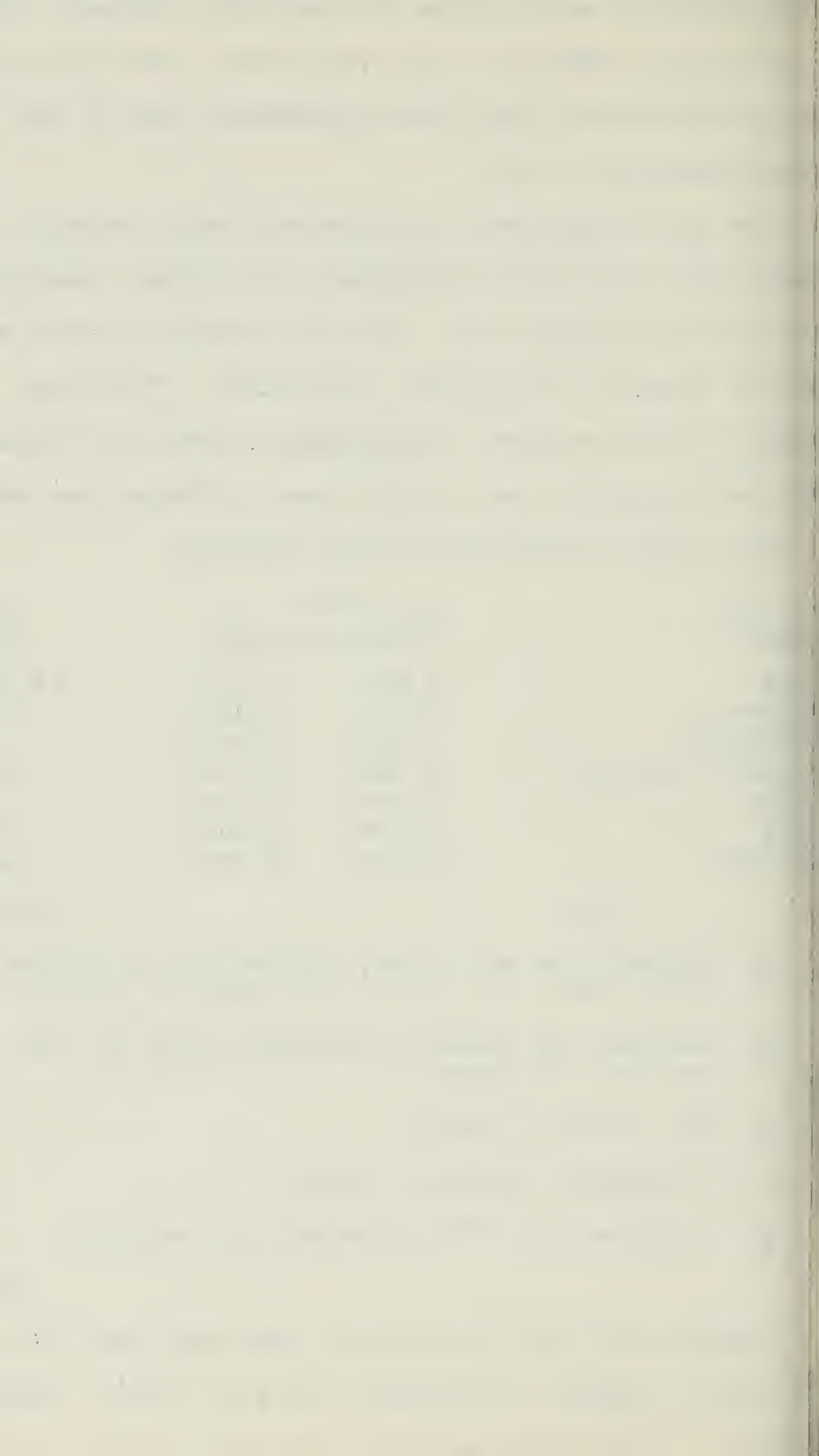
c/ Not shown of record.

d/ Presumably suckling calves.

e/ Comprised of 170 steers and 170 heifers.

(R. 444)

Vaughan also sold 60 heifers that were over 12 months of
to Robert Vaughan in November, 1951 (R. 445). Complete
idation of the breeding herd and dissolution of the partner-



ni was accomplished by December 31, 1952 (R. 252).

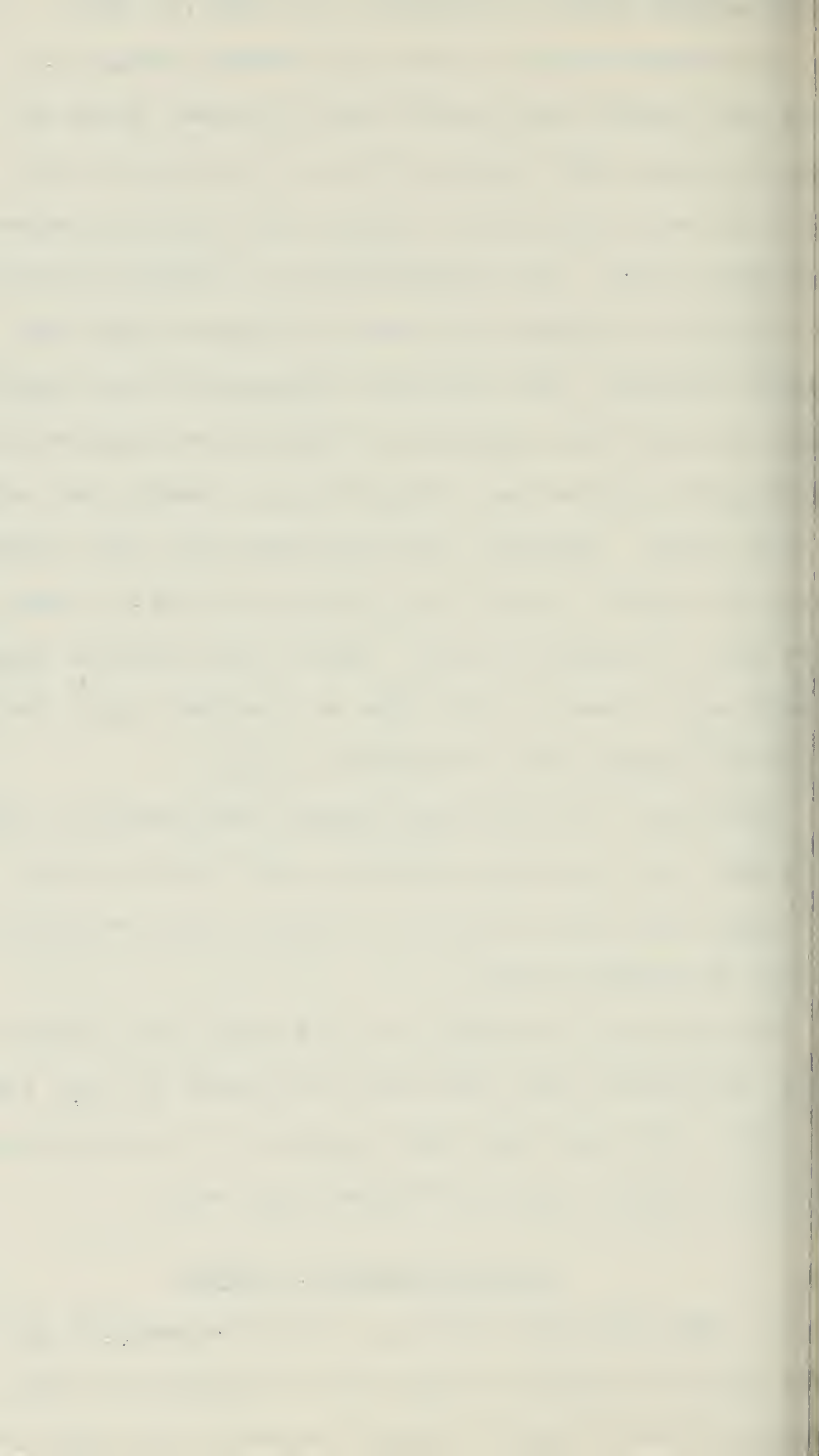
The Commissioner of Internal Revenue refused to allow
auhan any capital gain on the sale of cows, bulls or heifers
irng the years 1947 through 1950 on the grounds that the
itle sold were not held by Vaughan for breeding purposes
irng those years. The Commissioner of Internal Revenue con-
ned that the proceeds received by Vaughan under the contract
isrental income! The Tax Court determined that Vaughan was
ittled to treat the payments to Milford as compensation for
rorming his contractual obligation of running and managing
iecattle herd. Further, the Tax Court held that Vaughan was
ittled to capital gains from the sale of bulls, cows, and
iers over 24 months of age. Under this decision capital gains
etment was allowed on the sale of cows and bulls for all years,
idsale of heifers over 24 months of age.

Similarly, in 1951 when Vaughan was forced to liquidate
iegreatest part of their breeding herd the Tax Court determined
ia Vaughan was not entitled to capital gains on any heifers
s than 24 months of age.

The question presented on this appeal is whether the
iers, including those less than 24 months of age, sold in
4, 1949, 1950 and 1951, were members of the breeding herd and
slted in capital gain to Vaughan when sold.

SPECIFICATIONS OF ERROR

1. The Tax Court erred in its determination that the
iers under 24 months of age sold by Vaughan in 1948, 1949,
5 and 1951 were held by Vaughan primarily for sale to customers



n ne ordinary course of business rather than for breeding urposes.

2. The Tax Court erred in its determination that Vaughan as not entitled to report as long term capital gain the gain ro the sale of at least one-half of all of the heifers under 4 onths of age sold in 1948, 1949 and 1950.

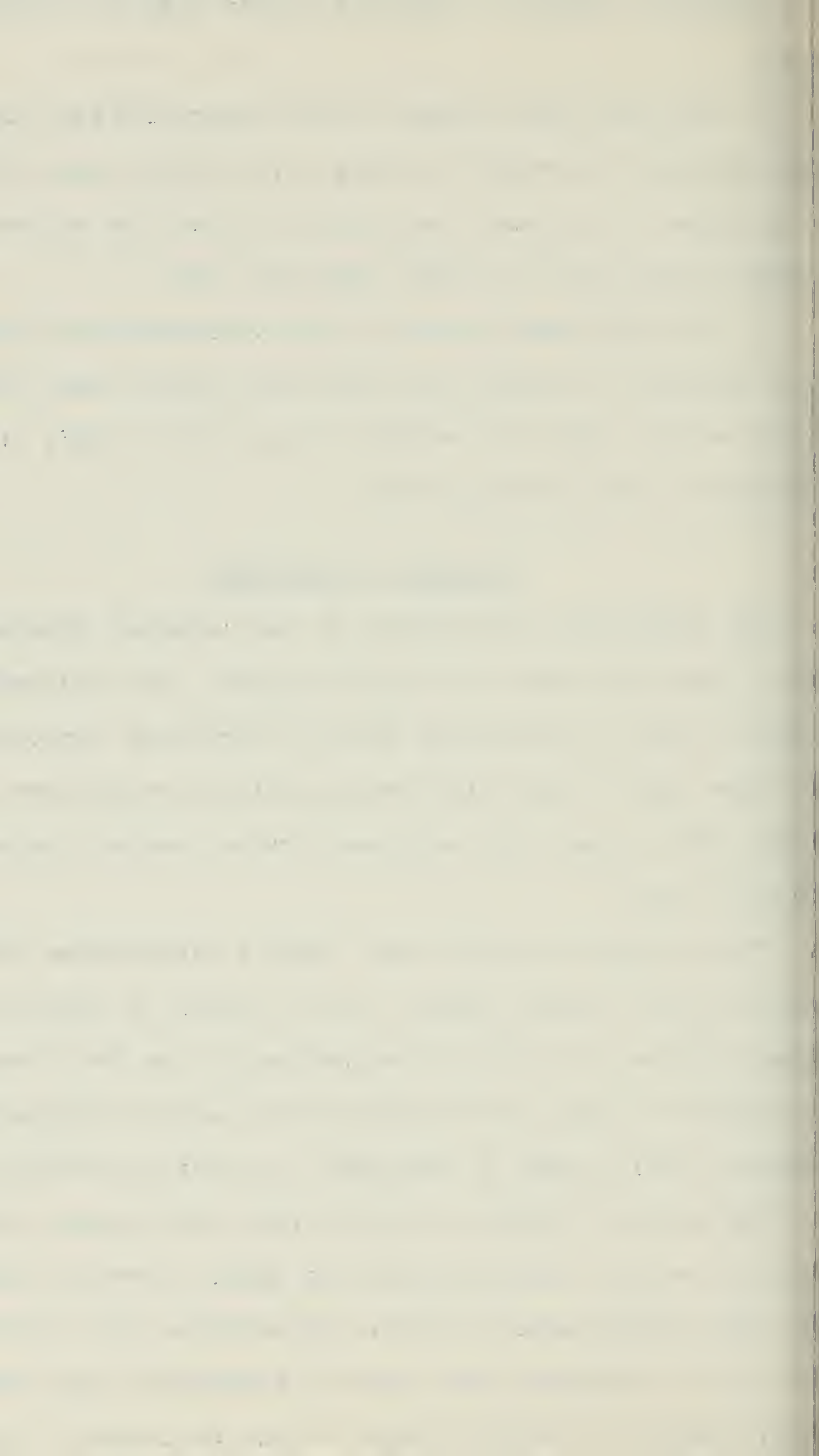
3. The Tax Court erred in its determination that Vaughan as not entitled to report as long term capital gain the gain ro the heifers under 24 months of age sold in 1951 in partial iqidation of its breeding herd.

SUMMARY OF ARGUMENT

. The applicable provisions of the Internal Revenue Code erit a livestock owner to obtain capital gain treatment from roeeds of sale of livestock held for breeding purposes regard-es of the age of the animal when sold and regardless of the ac that such animal has not been bred or has not reproduced at ne time of sale.

I. The evidence in this case clearly establishes that Vaughan el all heifers raised during the tax years in question for eding purposes and the determination by the Tax Court that all ers under the age of 24 months were held by Vaughan primarily or sale in their trade or business is clearly erroneous.

II The sale of heifers in 1951 after termination of the ngement contract with Milford and after carrying the animals rugh the winter season clearly establishes said heifers to be mers of the breeding herd and the subsequent sale of said heifers ttled Vaughan to capital gains on the proceeds of such sale.



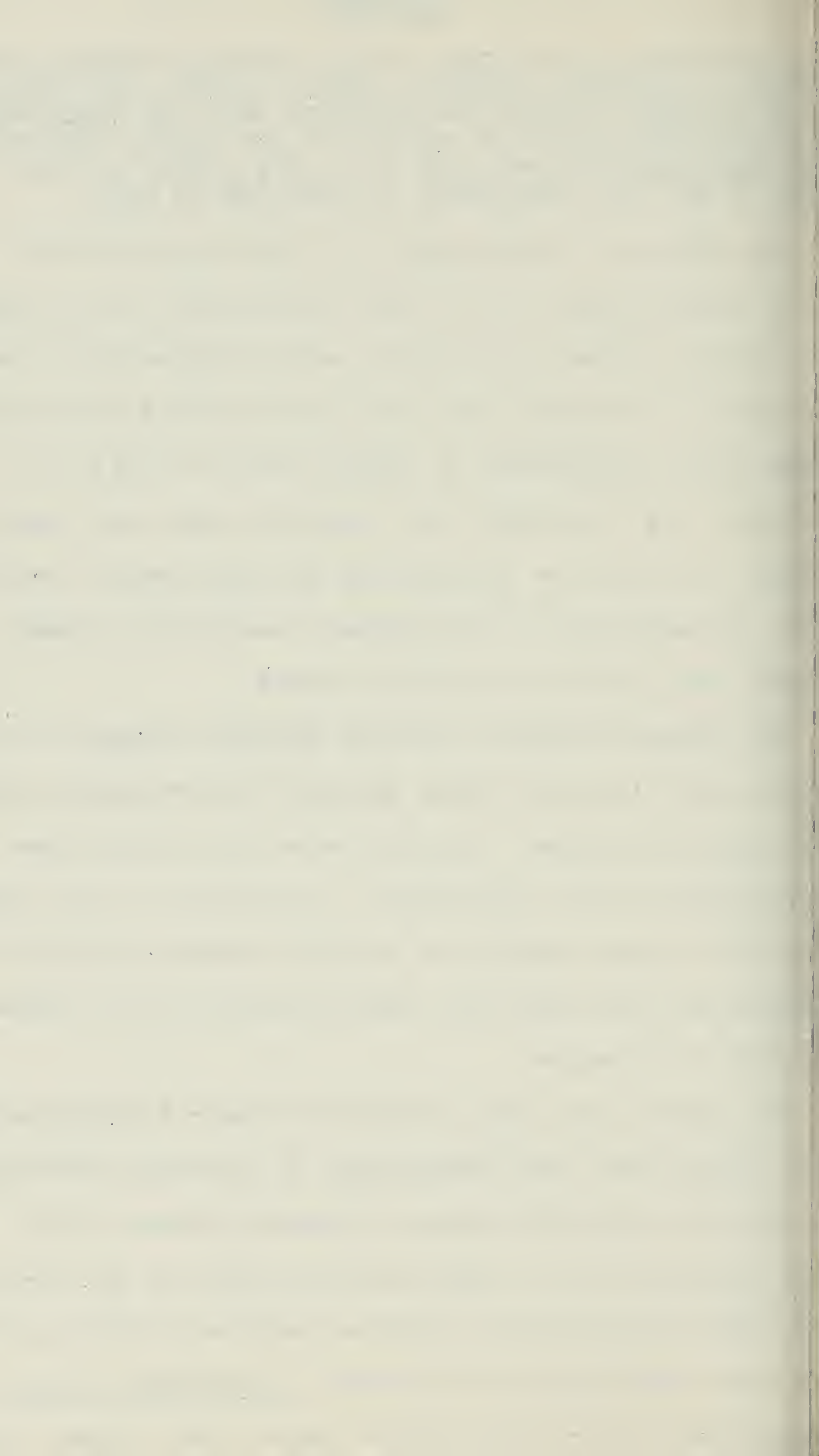
ARGUMENT

HE APPLICABLE PROVISIONS OF THE INTERNAL REVENUE CODE ERMIT A LIVESTOCK OWNER TO OBTAIN CAPITAL GAIN TREATMENT ROM PROCEEDS OF SALE OF LIVESTOCK HELD FOR BREEDING URPOSES REGARDLESS OF THE AGE OF THE ANIMAL WHEN SOLD ND REGARDLESS OF THE FACT THAT SUCH ANIMAL HAS NOT BEEN RED OR HAS NOT REPRODUCED AT THE TIME OF SALE.

The Internal Revenue Code of 1939 was amended by Section l() of the Revenue Act of 1942 and Section 127 of the Revenue t f 1943 to include as capital assets depreciable assets used te trade or business and held for more than six months. The enment was accomplished by adding Section 117(j) to the Code. atsection also provides that property which was properly cldible in inventory or was held by the taxpayer primarily r ale to customers in the ordinary course of a trade or busi- sswould not qualify as capital assets.

The Commissioner of Internal Revenue refused at first to conize that livestock could qualify for treatment under the pial gains provision. He next ruled that only those sales of eeing animals that constituted a reduction in the taxpayer's eeing herd would qualify as capital assets and then only after nimals had been used for substantially all of their normal efl life as breeders.

The courts were more liberal in their interpretation of cton 117(j) than the Commissioner of Internal Revenue. As a ut of this conflict Congress amended Section 117(j) of the enal Revenue Code of 1939 by Section 324 of the Revenue Act 151 which specifically provided that the capital gains pro- sins were applicable to livestock, <u>regardless of age</u>, held for ncths after acquisition for the years 1942 through 1950, and

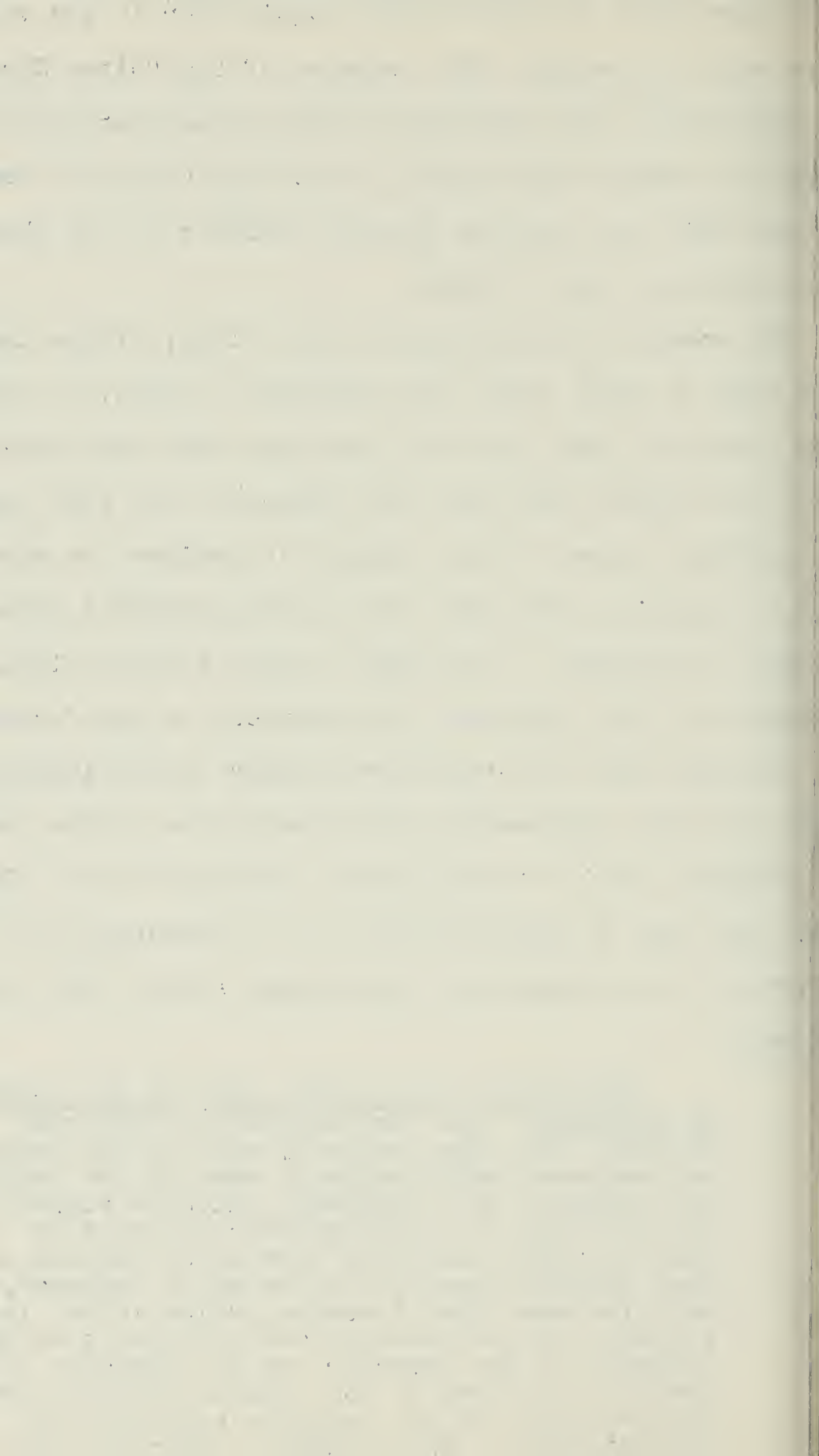


ld for more than 12 months after acquisition in the year 1951
d he years following. The Congress of the United States was
it specific in the legislation that age was not the prime
qusite so long as the holding period was satisfied and the
iml was held for breeding purposes whether or not the animal
d eproduced at time of sale.

The courts in construing Section 117(j) of the Internal
veue Code of 1939, after its amendment in 1951, in cases in-
lvng livestock have all been concerned with the problem of
eter the animals sold were held primarily for sale to customers
te ordinary course of the taxpayer's business or whether the
imls in question were held for breeding purposes even though
ve used as breeders. The cases on this subject disclose that
e nswers to these problems are dependent on the facts in each
se In each case the courts have looked to the intent of the
xpyer, and the surrounding facts indicative of the intent.

Section 117(j) of the Internal Revenue Code of 1939 was
le to the Code by Section 151(b) of the Revenue Act of 1942
l rior to its amendment by the Revenue Act of 1951, provided
fllows:

> "Definition of property used in the trade or business. For the purposes of this subsection, the term 'property used in the trade or business' means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), held for more than 6 months and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade



> or business. Such term also includes timber with respect to which subsection (k)(1) or (2) is applicable."

Section 117(j)(1) of the Internal Revenue Code of 1939 was

ended by Section 324 of the Revenue Act of 1951, 65 U.S. Stat.

l as follows:

> "Section 117(j)(1) is hereby amended by adding at the end thereof the following new sentences: 'Such term also includes livestock, regardless of age, held by the taxpayer for draft, breeding, or dairy purposes, and held by him for 12 months or more from the date of acquisition. Such term does not include poultry.' The first sentence added to section 117(j)(1) by the amendment made by this section shall be applicable with respect to taxable years beginning after December 31, 1941, except that the extension of the holding period from 6 to 12 months shall be applicable only with respect to taxable years beginning after December 31, 1950. The second sentence added to section 117(j)(1) by the amendment made by this section shall be applicable only with respect to taxable years beginning after December 31, 1950."

The Commissioner's Income Tax Regulations 118, Section 39,

7j)(2) provides in part:

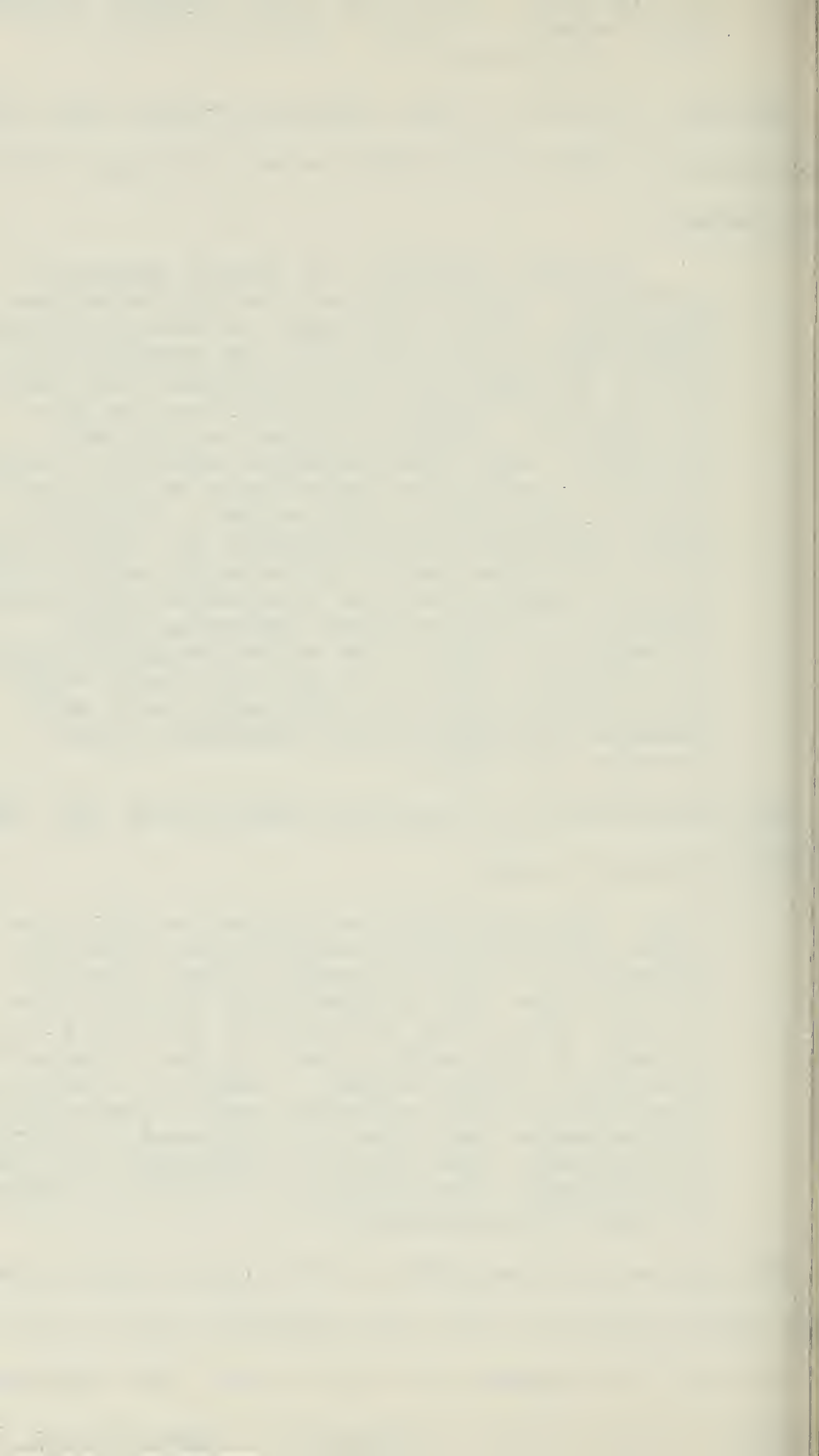
> "(b) The determination whether or not livestock is held by the taxpayer for a draft, breeding, or dairy purpose depends upon all of the facts and circumstances in each particular case. The purpose for which the animal is held is ordinarily shown by the taxpayer's actual use of the animal. However, a draft, breeding, or dairy purpose may be present in a case where the animal is disposed of within a reasonable time after its intended use for such purpose is prevented by accident, disease, or other circumstances."

An instructive discussion of the provisions of Section 117(j)

hey existed prior to the 1951 amendment and of the remedial

fect intended by Congress in enacting the 1951 amendment to

section, is set forth in <u>McDonald v. Commissioner of Internal</u>



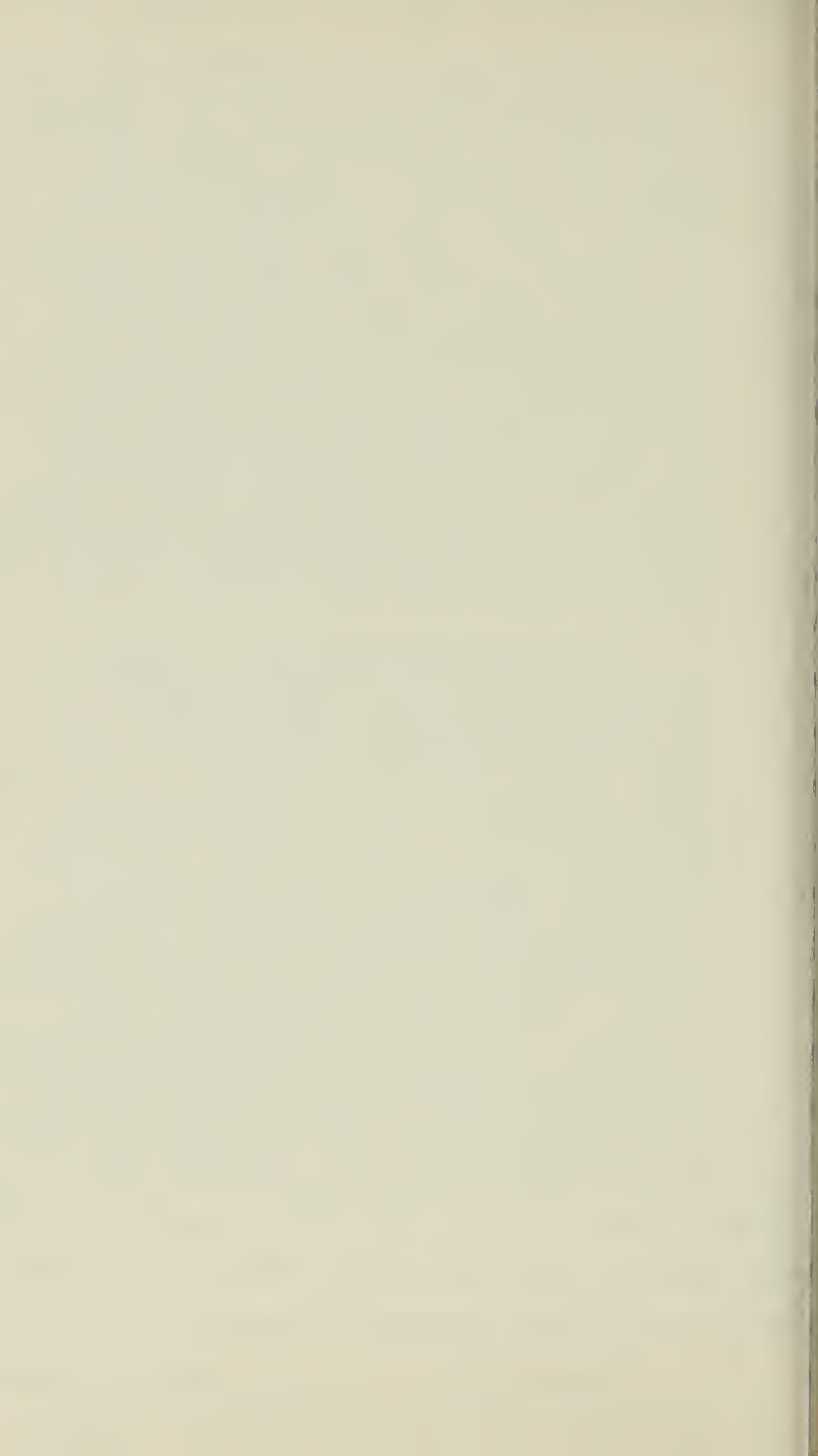
veue, (1954)(CA-2), 214 F.2d 341, as follows:

"Prior to this 1951 amendment the Commissioner had first refused to recognize that livestock could qualify for treatment under the capital gains provision, and then had ruled that only unusual reductions of herd would suffice. A series of adverse rulings in the courts, Albright v. United States, 8 Cir., 173 F.2d 339; United States v. Bennett, 5 Cir., 186 F.2d 407; Miller v. United States, D.C.Neb., 98 F.Supp. 948, led him to modify his position so as to allow such treatment of animals sold after being employed for substantially their full period of usefulness. Treas. Dept. Bull. June 17, 1951, Mim. 6660, 1951-2 Cum. Bull. 60. But all of the foregoing cases had given the section a far more liberal interpretation than this, granting favored treatment to the proceeds from young animals, and in two of the cases from heifers (females which had never dropped a calf).

"When Congress undertook to amend §117(j)(1), it was made fully cognizant of this situation by representatives of livestock and breeding associations. Hearings before Committee on Finance on H.R. 4473, Revenue Act of 1951, Part. 3, pp. 1538, 1837, 2396; Sen. Rep. No. 781, 82d Cong., 1st Sess. 41-42. And it is manifest that the section was drafted with an eye to the breeders' complaints. Thus in defining property 'used' in the business the amendment speaks of livestock 'held' for an appropriate purpose, and adds the further proviso that it apply 'regardless of age.' The intent to repudicate the Commissioner's view is obvious, even without the specific statements in the Report of the Senate Committee on Finance, supra. And it is equally clear that the animal need not be mature and need not have been put to its intended use."

Also, Senate Report No. 781, 82d Congress, 1st Session, S.Code Cong. and Adm. Ser., 1951, 2012, contains the following planation of the 1951 amendment to Section 117(j):

"Thus section 117(j) will apply to livestock used for draft, breeding, or dairy purposes, and to turkeys used for breeding



purposes, whether old or young; and the holding period will start with the date of acquisition, not with the date the animal or fowl is put to such use."

The provisions of Section 117(j) require that the livestock eld for breeding purposes, and also require that the livestock eld for that purpose for more than six months (or 12 months r1951) after the date of acquisition thereof. Whether an ial is held for breeding purposes and not primarily for sale eents a question of fact. . . United States v. O'Neill, (1954) A9) 211 F.2d 701, 702.

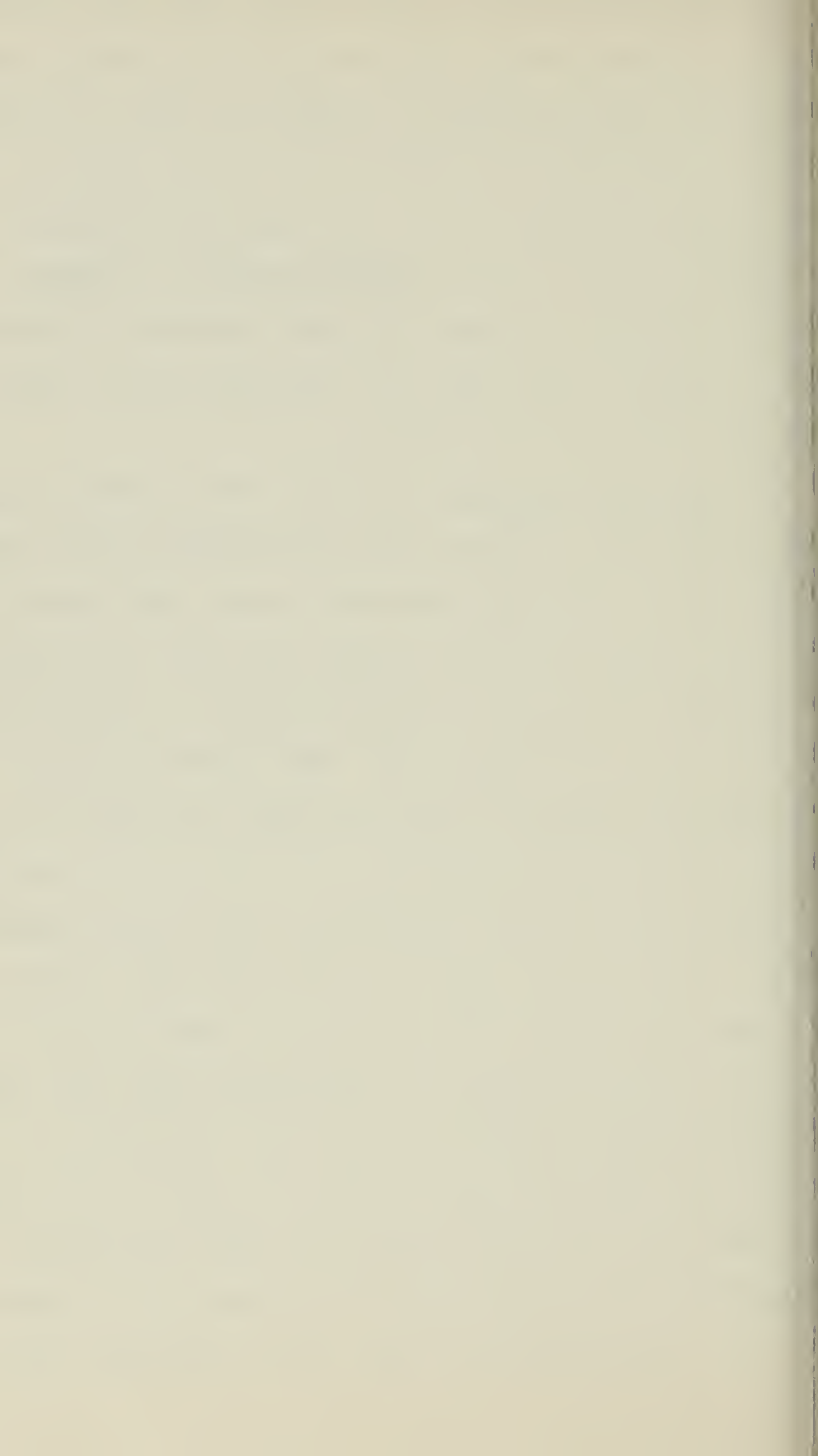
Generally, the cases involving livestock that have been tgated have considered the question of whether the animals l were held for sale in the ordinary course of business, and equestion of whether the animals qualified as breeding animals. nalysis of many cases on these subjects disclose that the sers to these problems are dependent on the facts in each s. In each case the courts have looked to the intent of the xayer, and the surrounding facts indicative of the intent. eof the first, in a long series of cases dealing with this tect, is Albright v. United States, (1949)(CA-8) 173 F.2d 339, eein the court allowed capital gains on the sales of animals c a dairy herd when it was no longer economically beneficial etain said animals. The same result was reached with respect he sale of breeding sows which were sold each year after ting only one litter. The decision in this case struck down eCommissioner's rulings on the subject as being incompatible t the laws passed by Congress. The court decided that even

ugh it was the practice to sell culls from the breeding herd, they were not held primarily for sale in the ordinary course of business, and thus qualified as animals entitled to capital gain treatment under Section 117(j) of the Internal Revenue Code of 1939 as it existed prior to the 1951 amendment thereto.

Another early case was United States v. Bennett, (1951) (CA5) 186 F.2d 407, wherein the court approved the treatment of gain on sale of culls from the breeding herd as long term capital gain under Section 117(j).

In Fawn Lake Ranch Co., 12 T.C. 1139, capital gain was allowed on the sale of culls from the breeding herd, regardless of whether or not they had produced calves, and regardless of the fact that they were sold because they had not produced calves.

Another early case is Miller, et al v. United States, (1951) USDC Neb., 98 F.Supp. 948. The court held that the annual sale of heifers ranging in age from about 18 months to more than two years, sold because they were not likely to be good breeders, constituted sale of capital assets and that capital gains resulted therefrom. In reaching this decision, the court noted that the owner was saving all of his heifers in order to build back his breeding herd to maximum capacity. The heifers sold had, prior to sale, been included in the breeding herd and exposed to breeding. These facts, which involve a herd of range cattle, and are practically identical with those present in this proceeding, the court found that the heifers sold had been a part of the breeding herd and were not animals held for sale in the ordinary course of business.



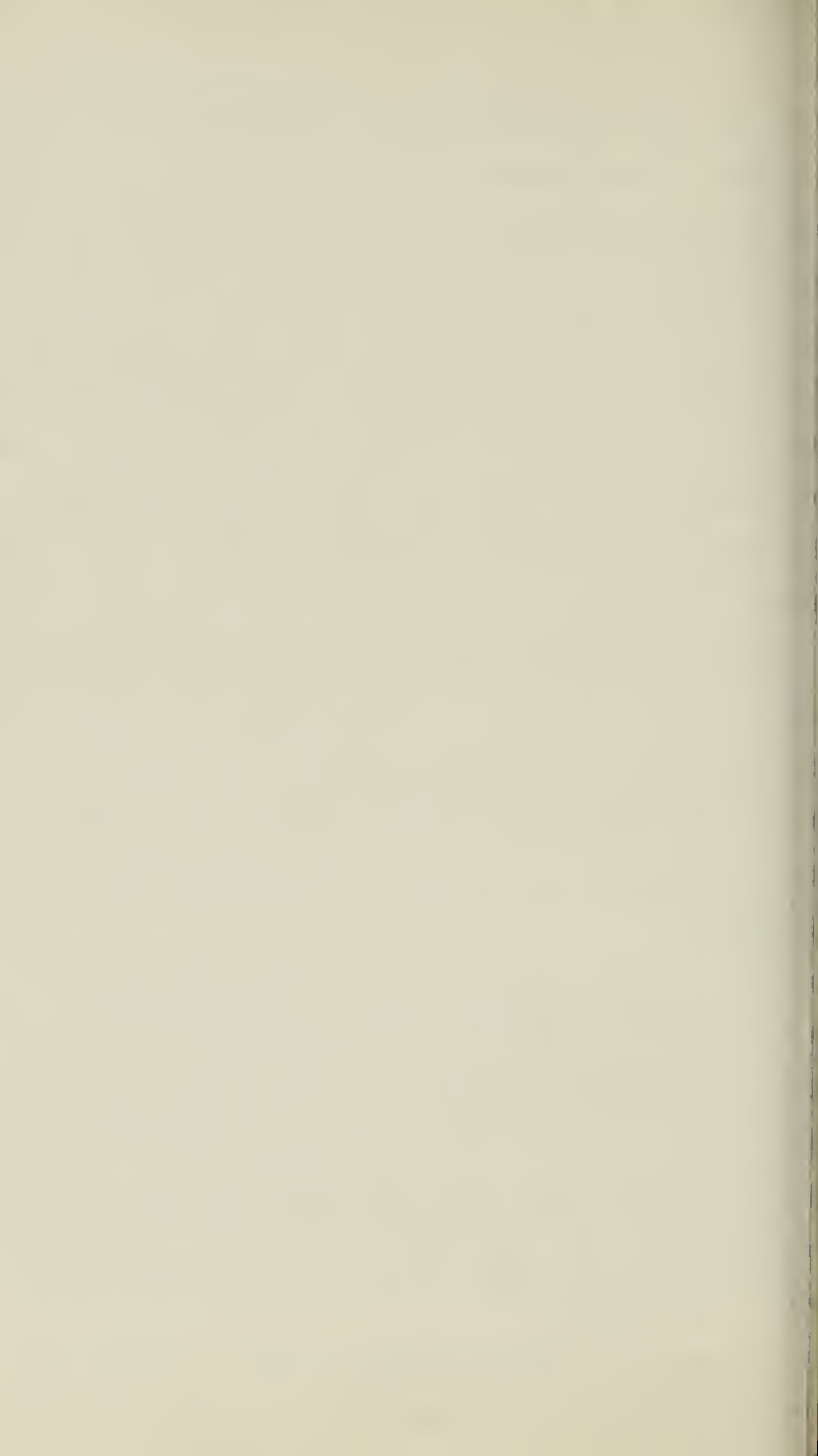
In Pfister v. United States, (1952) USDC So. Dak., 102 F.
p. 640, reversed on another point, USCA 8, 205 F.2d 538, the
iers in question were raised by the plaintiff and were held
r breeding purposes from their birth until they were about one
a old. The heifers were separated from the rest of the herd
ne spring of the year following the year of their birth.
e they were more than a year old, they were turned in to a
prate pasture along with the bulls, and thereby exposed to
eding from July to the fall of said year in which so separated
o the herd. In the fall of the year, after thus being used
reeding animals, the heifers were sold. The evidence showed
a said heifers were part of the plaintiff's breeding herd,
d that they were sold because of the prevailing shortage of
cssary ranch help. The court allowed Pfister to report the
i on the sale of the heifers as capital gain. This part of
decision by the court was not disturbed by the Court of
pals.

The cases of Pfister, Albright, Bennett and Miller, herein-
fre discussed, were all decided prior to the effective date
he amendment to Section 117(j) contained in Revenue Act of
5. One of the first cases decided after the 1951 amendment
s McDonald v. Commissioner of Internal Revenue, (1954)(CA-2)
4 F.2d 341, which contains an excellent analysis of the law up
hat time, and the effect of the amendments as heretofore dis-
sed on page 14. The court emphasized that the intent of the
xayer, in dealing with his animals, is controlling, and that
ee an animal is deemed part of the breeding herd from birth,

ualifies as an animal held for breeding purposes even though ny be disposed of before it has matured or before it has been tully used as a breeder. In the McDonald case, the taxpayer nd a herd of thoroughbred dairy cattle of championship quality. e herd was being increased in size during the period involved. Donald retained the best calves as part of the herd. The ling of the offspring commenced when the calves were very ug and was a continuous process. The question involved was e nature of the proceeds received from the sale of cattle that re culled out of the herd and sold. The court noted that the rpse for which an animal is held is essentially a question of ct. The court treated the proceeds from the sale of animals led from the breeding herd as capital gains despite the fact at the taxpayer knew, at the time that each annual crop of inls was added to the breeding herd, that part of said animals dded to the herd would develop undesirable characteristics thereby require the culling that ultimately occurred. The ur stated:

> "Of course it was in the taxpayer's contemplation that many or most of the animals would be found wanting and be sold. The operation might perhaps even have proved unfeasible without the income thus derived. And in a very real sense the taxpayer could have said at any moment that most of his calves were held for possible sale. But this was not the motive behind their retention, and legislative history of the new law shows that motive is to be controlling. And it is this new law which is and must be decisive."

In O'Neill v. United States, USDC, S. Dist. Cal., 52-2 USTC r. 9462, aff'd CA-9, 211 F.2d 701, the taxpayer contested the



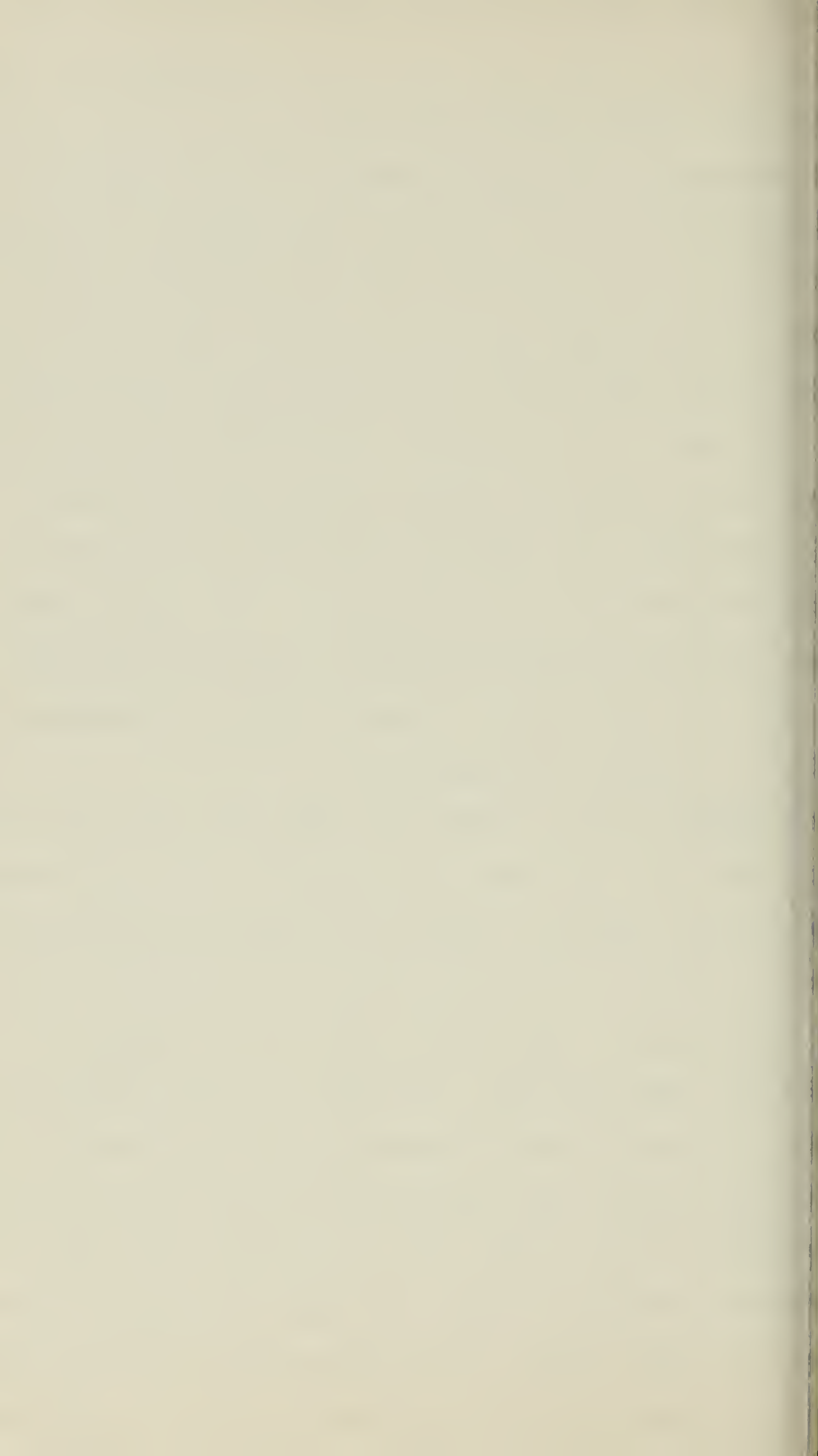
mmssioner's determination that gain on sale of certain heifers
s rdinary income. The taxpayer was beneficial owner of part
atrust that operated a herd of beef cattle. The facts estab-
shd that the heifers sold in the year in question were sold
ase of adverse water and range conditions. The heifers were
ord heifers, but would have been exposed to breeding and placed
te breeding herd except for the adverse range conditions. The
ir decided that the heifers sold were held by the trust for
eding purposes within the meaning of Section 117(j) of the
enal Revenue Code, and had been held for more than six months,
is entitling plaintiff to report his proportionate share of the
ceds as long term capital gain.

In Estate of C. A. Smith, 23 T.C. 690, Acq. 1956-1 CB 5,
etitioner raised thoroughbred Hereford cattle. He maintained
erds of cattle. The outstanding animals raised by the
iioner were in a segregated breeding herd, or were destined
b placed therein at the proper age. The remainder were
rgated in a sales herd. Frequently, animals of the breeding
d some of which had never been bred, were exhibited at stock
w and sold at auction thereafter. The court noted that the
emination of which animals, if any, were held by the petitioners
reeding purposes was essentially a question of fact. In its
ison, the court held that the animals sold, being of very
h quality, were those ordinarily retained as breeding stock,
ere sold only under unusual circumstances. The court held
tit made no difference that many of the animals had never
n used for breeding purposes. They had been held for breeding

pses, even though petitioner knew from year to year that
tin of the animals selected for the breeding herd would be
d as show animals before breeding.

In Deseret Live Stock Company, Para. 53,093, P-H Memo. TC,
etitioner operated a herd of range cattle. Ordinarily, the
fers born to the herd were retained and added as replacement
mls or to increase the breeding herd. As a result of drought
oor range conditions, petitioners sold large numbers of
fers in 1946, 1947 and 1948. Petitioners did not raise heifers
ale in the ordinary course of business but raised them for
eding purposes, and regarded all female calves from time of
th as members of the breeding herd. The court allowed capital
n on the sale of heifers held for breeding purposes since the
es were not made in the ordinary course of business, but as
esult of unusual circumstances.

Bartlett, Para. 55,259, P-H Memo. TC, is a case directly
point with the case here in litigation. The petitioners
r operated a herd of cattle and expected to use practically
emale calves to build the herd to the maximum capacity of
arm operation. Ordinarily, the heifers would not have been
l but in 1949 and 1950, the years in issue, petitioners were
ned of funds for ranch expansion and improvements, and these
cumstances caused the petitioners to sell heifers out of the
d in each of said years. The court found that all of the
mal sales involved, except one where the animals were not held
ore than six months, constituted sales of animals held for
eding purposes which were entitled to capital gain treatment.

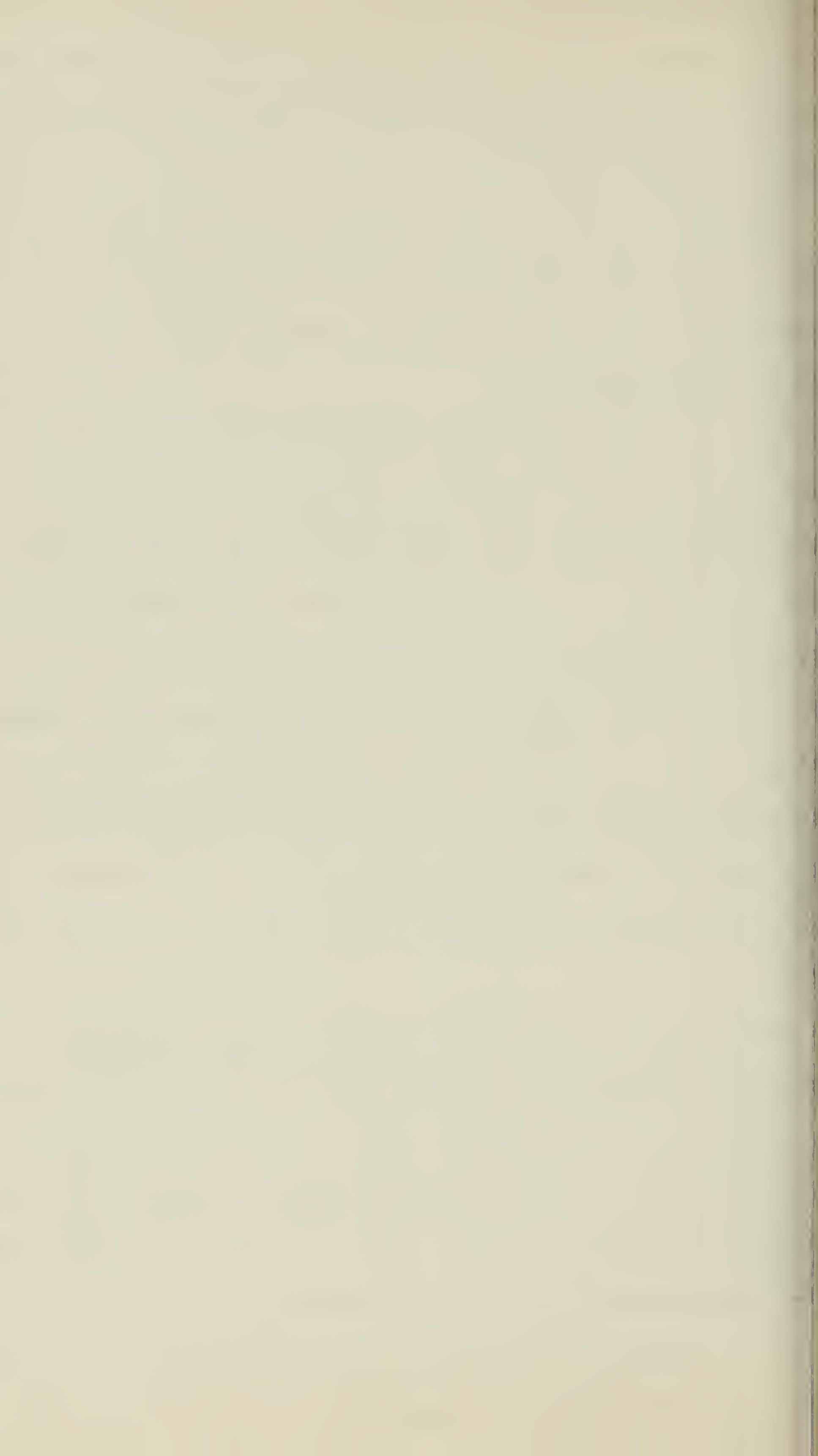


tl3 Bartlett case, of 26 heifers sold in 1949, 22 were 15 months a3 or younger, and of the 31 heifers sold in 1950, 27 were 14 itl3 of age or younger. In view of petitioners practice of not eding his heifers until they were 15 to 18 months old, none tl3 heifers sold were ever exposed to breeding. Nevertheless, ourt concluded that said animals were held for breeding p3es and that the proceeds from sale thereof should be accord- capital gain treatment.

The fact that immature animals constitute members of the eding herd, if held for that purpose, was emphasized in Smith, a 56,030, P-H Memo. TC. The court held that animals held for eing purposes, even though too young for actual breeding, situted animals held for breeding purposes.

A similar decision was reached in Miller v. Connell, USDC t Dist. Mo., 56-1 USTC Para. 9528, 141 F.Supp. 361 (1956), rin capital gain was allowed on the sale of heifers and cows dfor breeding purposes, despite the fact that many did not rduce during the period they were held as part of the breed- 3rd.

In Carter v. Commissioner of Internal Revenue, (1958)(CA-5), .2d 595, reversing in part 16 T.C.M. 280, the Court of els held that the taxpayer was entitled to capital gain on ale of heifers. The taxpayer had purchased 368 heifers and hem on pasture in April, 1947. In June of 1947, registered eord bulls were put in with the heifers to serve them. The pyer was unable to feed the heifers in the winter of 1947-48 t3 range and therefore determined to sell them. The heifers



e sold in March and April, 1948. The Court of Appeals decided t the taxpayer had the requisite purpose and intent to, and old the cattle for breeding purposes, and allowed capital n treatment on the sale of the bred heifers.

One of the more recent cases involving capital gain on e of cattle is <u>Harder, et al v. United States</u>, 59-1, USTC, a 9364, USDC East. Dist. Wash. Harder separated his young fers from his breeding herd until August of each year when y were exposed to breeding at the age of 16 to 18 months. All fers born into the Harder herd were considered members of the eding herd. In the fall of 1954 and 1955 range conditions e poor. Rather than expose the 16 to 18 month old heifers pegnancy, and place the bred heifers in his breeding herd, er sold the heifers. If Harder retained the heifers in the eding herd during 1954 or 1955, he would have been faced with ueconomical operation because he would have had to buy large nities of feed due to the poor range conditions. Harder ied capital gains on the sales of the unbred heifers, aged t 18 months, which were sold in the fall of 1954 and 1955, he court sustained said petitioner in his contention that apital gains so claimed were proper.

THE EVIDENCE IN THIS CASE CLEARLY ESTABLISHES THAT VAUGHAN HELD ALL HEIFERS RAISED DURING THE TAX YEARS IN QUESTION FOR BREEDING PURPOSES AND THE DETERMINATION BY THE TAX COURT THAT ALL HEIFERS UNDER THE AGE OF 24 MONTHS WERE HELD BY VAUGHAN PRIMARILY FOR SALE IN THEIR TRADE OR BUSINESS IS CLEARLY ERRONEOUS.

The facts in this case as established at trial through the tmony of two of the partners and Milford thoroughly substan-

ats the claim of petitioner that the heifers sold in the years 48 1949, 1950 and 1951 were members of the breeding herd, and re not held primarily for sale to customers in the ordinary ure of Vaughan's trade or business.

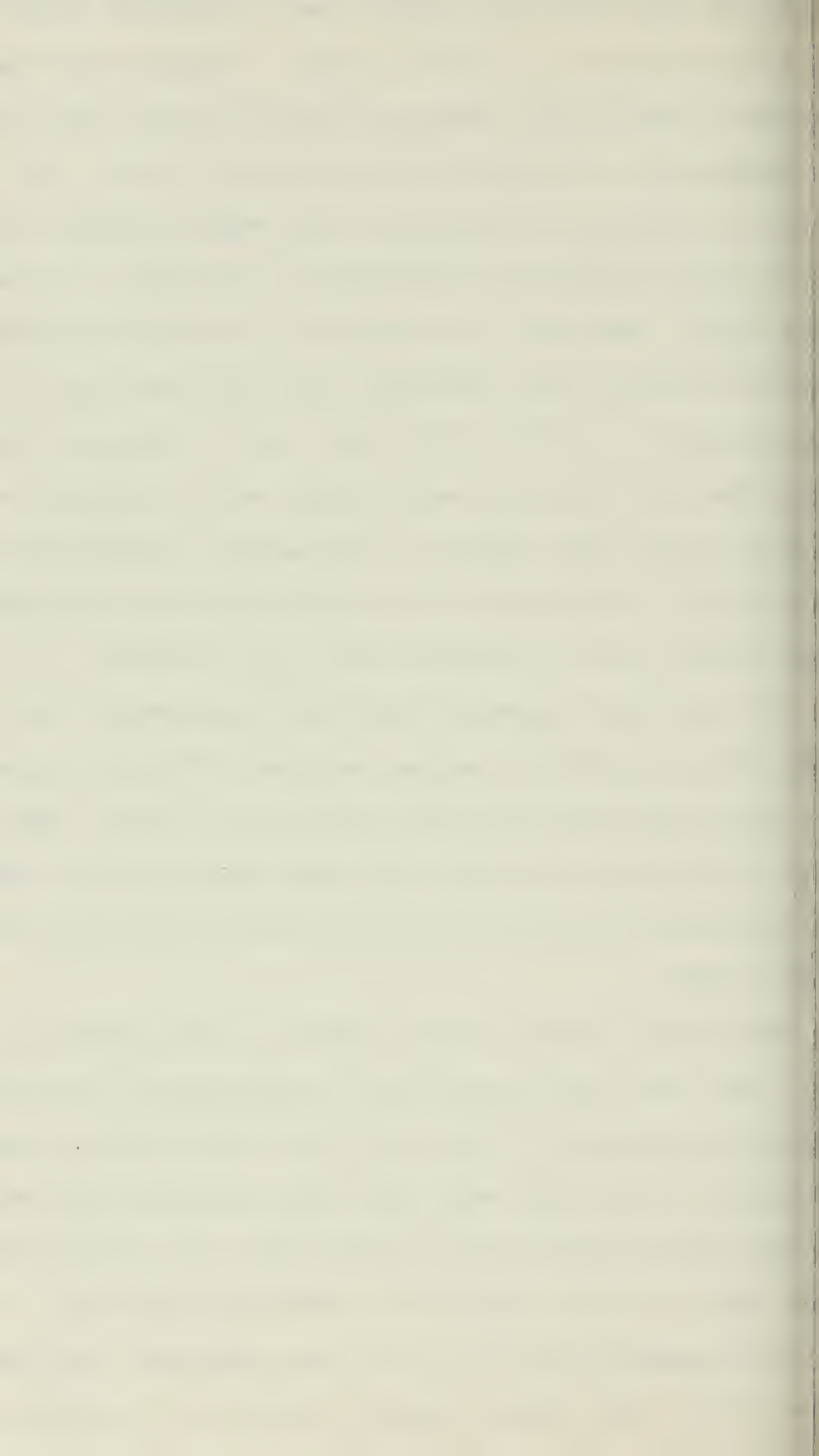
The Tax Court found as a fact consistent with the testi-ne that the number of count cattle turned over to Milford th the breeding herd was 1,364, or 64.95% of ranch capacity of 00 head of count cattle (R. 440). It goes without saying that e reatest economic gain would be realized by both contracting rtes by an operation at maximum capacity. Floyd and F. C. stfied that it was their intent and they hoped that Milford ul save back all heifer calves and build the herd back to its rmr size of 2150 count cattle (R. 160-166, 410, 411). The stmony of the partners as to their intent is on all fours with estimony of Milford. Milford was contractually responsible he management of the herd and determined the cattle to be ld each year in consultation with Vaughan. Obviously, Vaughan l o agree to the sale of enough cattle to permit Milford to ilze sufficient funds to continue performance under the contract. lfrd was informed by Vaughan that they had operated the ranch $,000 per month for operating expenses in years immediately lo to sale of the ranch to Milford (R. 335, 362). Had Milford nable to operate as cheaply as Vaughan, it would not have nnecessary for so many of the heifers to be sold. He was not le to operate as cheaply as Vaughan because there was only one lfrd while there were three working partners in Vaughan.

Floyd testified that Vaughan had spent about 10 years in

iling the herd that was turned over to Milford under the
ntact as of April 1, 1946 (R. 140). Vaughan took the herd
Buneau, Idaho in the spring of 1940 at which time it contain-
aproximately a thousand head of female cattle. In 1945, at
e ime of the sale to Crabbe and the Hawes brothers the herd
i een almost doubled and contained 2,150 head of count cattle
. 38, 266). The herd was reduced in size by the Hawes brothers
fore the contract was rescinded, and contained only 1,364 count
tte on April 1, 1946 (R. 79, 138, 161). Floyd and Vaughan
teded that the breeding herd turned over to Milford would be
il back to its size prior to its partial liquidation by the
we brothers. This was to be accomplished by retaining all
ifrs as part of the breeding herd (R. 160-162).

The contract empowered Milford to determine the animals to
sold after consulting Vaughan because Milford's operating funds
i o come from sales from the herd (R. 85, 159). The operating
pese of ranching increased each and every year of the contract
ia occasioned the sale of heifers other than culls (R. 179,
0, 254, 268).

The heifer calves became members of the breeding herd at
rth. They were never separated or segregated from the breeding
rd but were exposed to the herd bulls from birth, except for a
or period of the year when they were separated for winter feed-
g. The weaner heifers were turned out each spring with the
eding herd and were exposed to the bulls from May 1 until the
lowing December when the cattle were gathered and placed on
e feed lots. The weaner heifers turned out in March of each



ar were about one year old and were expected to breed by the me they were 15 months old. About 50% would produce a calf by e ge of 24 months (R. 241-246, inclusive).

The decision to sell the heifers in 1948, 1949 and 1950 s ade under identical circumstances in the fall of each year. e eason the heifers were sold in each year was to provide ffcient operating funds to Milford. The animals were gathered d egregated at the Battle Creek Ranch in late summer. The mbr of steers and culled cows were known at that time and ei approximate weights and the market price on beef. If the peted realization from the steers and cows did not provide lfrd with sufficient operating funds, then certain heifers re selected and sold to bring the sales proceeds up to a point er Milford could operate on his share and meet his increased peises (R. 180-197, inclusive).

Floyd testified that the heifers sold in 1948 were 24-30 ntis old and had been members of the breeding herd and exposed tie bulls for two seasons (R. 184). The heifers sold in 1949 re about the same age and had been members of the breeding herd d exposed to the bulls for breeding for at least two seasons . 189, 192). In 1950 there were three groups of heifers sold ngng in age from 12 to 24 months (R. 442), and had been members tie breeding herd and exposed to the bulls for breeding for at as one season for the youngest group weighing 453 pounds each d two seasons for all of the others (R. 194, 195).

The sum and substance of Floyd's testimony was that Milford peted to finance his operation of the breeding herd from his

ar of the proceeds from the sale of the steers and culled cows. e reeding herd was to be increased in size by the retention of l eifers. The only reason heifers were sold in each year was e ecessity to provide Milford with more money than had been tiipated to meet the constantly rising costs of operation.

The testimony of Floyd was substantiated by the testimony F C. He testified that Milford intended to build the herd rg enough during the contract period so that he would have a rdof his own from the increase. The only way to do this was kep all the heifers, other than the culls, as breeders. F. C. e that he would do just that (R. 410, 411, 412). The decision sll heifers was never made until it was apparent that Milford's ir from the sale of steers and culled cows would be insufficient fnance his operation (R. 414-416). The contract was negotiated te parties and the terms were agreed upon after considerable icssion and consideration by the parties. Milford agreed to efor the cattle for one-half of the sales proceeds and one-lfof the increase after making the original herd good because tought that he could operate on his share of the steer and ales and would have a good starter herd at the termination te contract from his share of the increase. The only way to rase this herd was by retention of all but the culled heifers 23-424).

The intent of Vaughan was subject to defeat by the sale of frs by Milford under the terms of the contract. What was lfrd's intent? His testimony was completely unbiased, he has outely no interest in the outcome of this litigation and his

stmony should not be discounted as self-serving statements. lfrd testified that it was his intent to, and he did treat all lfrs as members of the breeding herd from birth in order to an a herd of his own from his share of the surplus animals te end of the contract (R. 280, 281, 304-07, 321-24, 327-28, 5-6, 357-58, 368-70, 372-73, 376-77). Based on the operating st of Vaughan in prior years Milford thought that he could rte on his share of the proceeds of the steers and the cow le (R. 335, 362). However, the increase in operating costs hyear exceeded the increase in the price of beef on the hoof ilford was unable to operate as planned (R. 290-293, 367-70). ecision to sell heifers, in excess of those normally culled mthe herd each year as undesirable members of the breeding rd was made in the fall after the cattle were gathered and lfrd had calculated what his share of the sales price of the es and culls would be. Heifers were sold only to the extent esary to provide Milford with enough funds to repay the money hd borrowed during the year to finance the operation (R. 289,),326).

The uncontradicted facts in this case disclose that all te heifers became members of the breeding herd at birth. eywere exposed to the bulls for breeding purposes, and as a ttr of fact, many of the older heifers had produced calves fce the sale. None of the heifers sold were ever segregated omthe bulls and sold at a higher price as "open" heifers. The lytime heifers were sold was to provide Milford with enough ne to meet his obligation incurred in his performance under

e ontract. All of the cows, bulls and heifers sold during the ar here involved were livestock held by Vaughan for breeding rpses and held for more than 12 months from the date of acqui- tin.

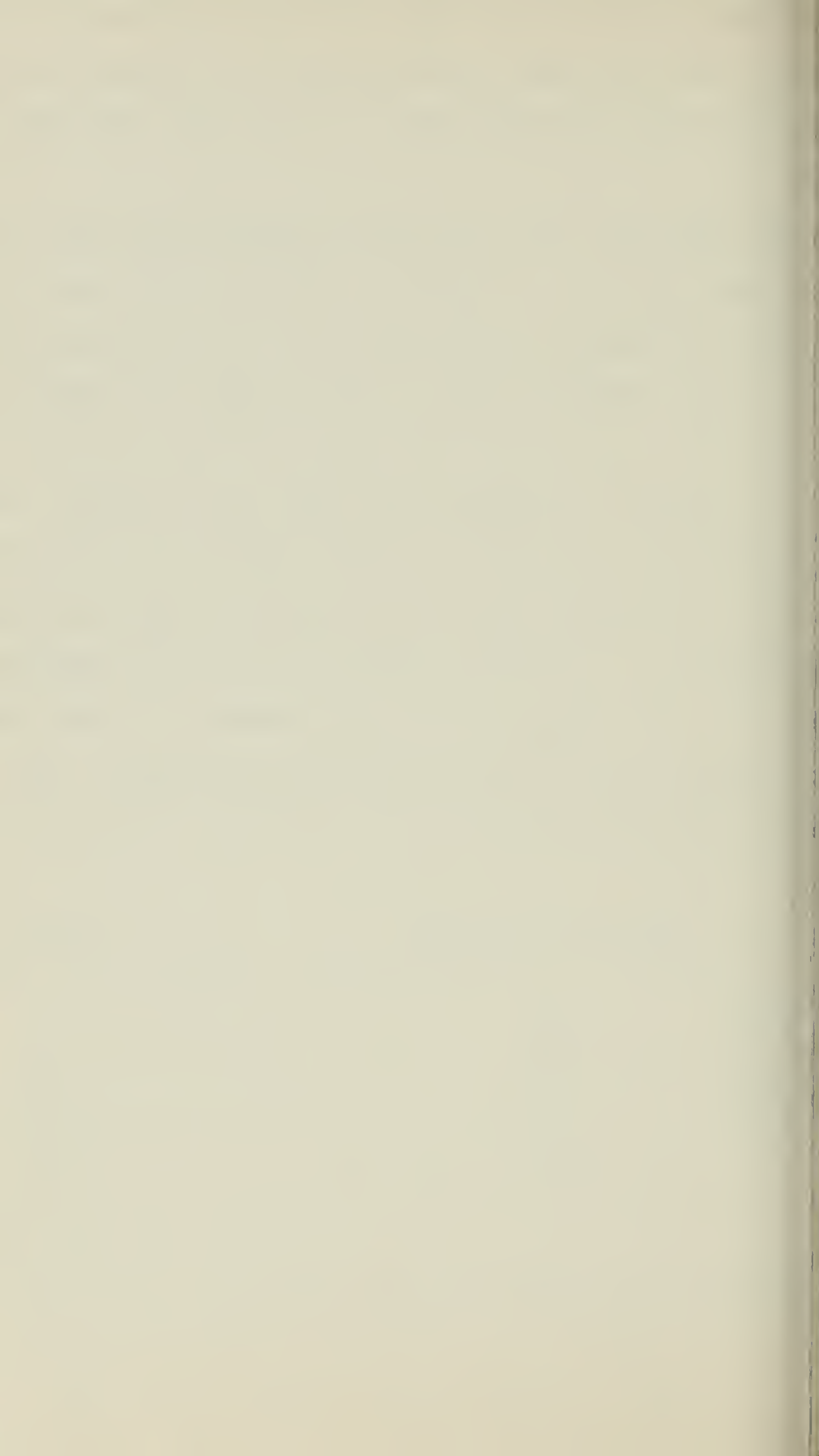
The Tax Court has completely ignored the tests set forth te cases heretofore discussed. They decided that despite e ntent of Vaughan and Milford that all heifer calves became mbrs of the breeding herd at birth, that the number of heifers ld under the contract did not manifest such an intent. In com- ig the number of heifers sold under the contract, the Tax ar erroneously included in their computations the animals sold 146 and 1947 which were in the breeding herd originally turned erto Milford. In order to obtain an accurate comparison of the ifrs sold with those retained, the members of the original eeing herd that were sold should be eliminated. The following a more accurate comparison of the heifers sold with those pro- e:

	Heifers Produced (One-half of Calves Branded)	Sold (Raised Under the Contract)
1946	339	-0-
1947	302	-0-
1948	358	96
1949	267	207
1950	370	245
	1636	548

(R. 89, 92, 98, 107, 115, 377)

e eifers sold in 1946 and 1947 were sold out of the original eeing herd turned over to Milford. Only about one-third of the ifrs were sold to produce funds needed by Milford.

There is absolutely no evidence in this record to support



e inding of the Tax Court that the heifers were held primarily r ale to customers in the ordinary course of business until eyreached an age of 24 months. The Tax Court's reasoning is nly unsupported by the evidence but is based upon an erron-usinterpretation of the evidence presented wherein the court ldit was important that :

1. Exposure to bulls was a meaningless act, except in rare and exceptional cases, until the heifers were at least 14 months old.
2. Normally the heifers do not produce a calf until they are 24 months of age.

The courts have long since rejected the contention that an iml is not a member of the breeding herd until it has actually odced a calf. At the risk of being repetitious, it is impor-ntto remember that in McDonald V. Commissioner of Internal veue, (1954)(CA-2) 214 F.2d 341, the court emphasized that the et of the taxpayer, in dealing with his animals, is controlling, hat where an animal is deemed part of the breeding herd from t, it qualifies as an animal held for breeding purposes even ouh it may be disposed of before it has matured or before it een actually used as a breeder.

The exposure of a heifer to the bulls in a breeding herd lc to the age of 14 or 15 months may be a useless act as deter-ne by the Tax Court but it certainly is indicative of the tet of the owner of that herd that every heifer is a member te breeding herd. Additional evidence of such intent is the ctthat all of the weaner heifers 12 months and older were

ed as breeders in ascertaining the number of bulls required

Idaho law to properly care for the breeding herd. It should

be noted that "open" heifers, those not exposed to breeding,

s brought a higher price when sold.

The Tax Court's determination that the heifers were sub-

to sale at any time during the period from 14 to 24 months

t visibly pregnant (R. 453) simply is not supported by the

d.

All of the testimony of Milford, Floyd and F. C. shows

the only time heifers were put up for sale, other than the

, was in the early fall of the year after it had been deter-

that the steers and culled cows and heifers did not produce

cash to enable Milford to pay off his debts incurred under

anagement contract. The visibly pregnant animals were not

because they were more valuable to petitioners with calf

an animal that was not visibly pregnant. The selection in

all was not made for purposes of keeping certain animals as

ers but was made on the basis of which heifers should be sold

it became known that heifers would have to be sold.

The Commissioner's Regulations 118, Section 39.117(j)(2),

, anticipate that even though animals are intended for

ing, they may have to be sold where circumstances change and

intended purpose is prevented by accident, disease, or other

mstances. The "other circumstances" was held to be sale of

in <u>McDonald</u>, supra; sale of heifers because of adverse

conditions in <u>O'Neill</u>, supra, <u>Deseret Live Stock Company</u>,

, <u>Carter</u>, supra, and <u>Harder</u>, supra; and sale of heifers to

ov le funds in Bartlett, supra. If the courts deciding the ove cases had used the tests used by the Tax Court here, namely, e age of the animals, and the number sold, none of the above ses could have been decided in favor of the taxpayer. In Pfister, Neill, Deseret, Bartlett, Carter and Harder substantial numbers heifers and in some cases all of the heifers of a given age oup were sold in one or more consecutive years. Similarly, st of the heifers sold were 24 months of age or less. It is ysal clear that the heifers sold out of the Vaughan herd were ld only because of the changed circumstances contemplated by e regulations and any gain on their sale resulted in capital in. The animals were not held primarily for sale in the inary course of Vaughan's business of raising and selling ng yearling beef steers.

It is respectfully submitted to this Court that there is soutely no evidence in the record to support the Tax Court's cision and the decision should be reversed with respect to all ifrs sold in the years 1948 through 1951. The Tax Court has pled tests to the animals sold in this case that have been ecfically repudiated by Congress and the courts with respect wether or not animals were held primarily for breeding purposes.

I. THE SALE OF HEIFERS IN 1951 AFTER TERMINATION OF THE MANAGEMENT CONTRACT WITH MILFORD AND AFTER CARRYING THE ANIMALS THROUGH THE WINTER SEASON CLEARLY ESTABLISHES SAID HEIFERS TO BE MEMBERS OF THE BREEDING HERD AND THE SUBSEQUENT SALE OF SAID HEIFERS ENTITLED VAUGHAN TO CAPITAL GAINS ON THE PROCEEDS OF SUCH SALE.

Selection of cattle for the replacement herd to be returned Vughan under the contract, and division of the increase in the

commenced in January, 1951 and was completed on or about
1, 1951, the termination date of the agreement. In January,
Vaughan and Milford made a tentative division of the herd.
an had a total of 1,096 cows and 2-year old heifers to be
ned to them. Vaughan selected 850 cows and segregated them
ilford agreed to pay Vaughan for 250 cows. This satisfied
eplacement of the cows and older heifers which Vaughan was
led to receive. Of the 850 cows Vaughan selected, Vaughan
150 cows and their sucking calves and 196 cows without any
s back to Oregon and Milford agreed to put the rest of his
in the remaining cattle. Of the cattle moved to Oregon, 202
were sold to one Barlow because he could not run them on
r Grazing Act land unless he owned them.

Vaughan returned to Idaho about April 1, 1951. They could
ccommodate all of the remaining cattle which they owned, and
unable to reach an agreement with Milford to continue taking
of the cattle, sold 200 cows out of the remaining 500 to
rd (R. 203). There were also 450 animals left in the yearling
. Vaughan was entitled to 230 as replacements plus one-half
e remaining 220, or a total of 340 head of yearlings divided
lly between steers and heifers, each numbering 170 (R. 203).
an did not have facilities for these cattle and sold all of
to Milford.

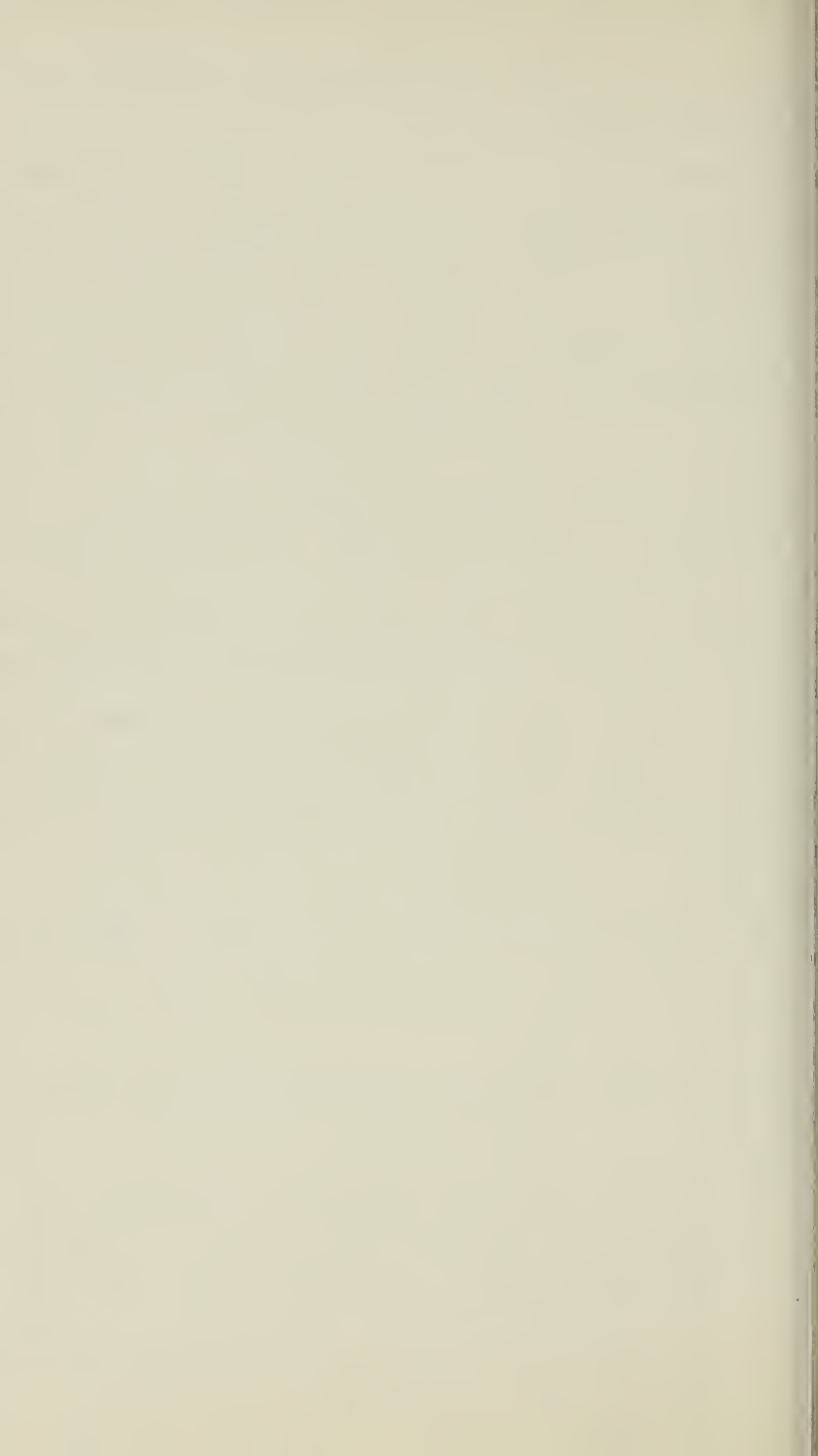
Vaughan claimed capital gain on the sale of the 200 cows
were categorized by the Tax Court as 150 cows between the
of 4 and 8 years and 50 heifers age 20 to 24 months. These
als had been accepted by Vaughan as part replacement of cows

d year old heifers and had been members of the breeding herd d xposed to the bulls for breeding for at least two full as ns (R. 315, 316).

The Tax Court in refusing capital gain treatment on the h ifers has completely overlooked the fact that these animals re segregated as replacements of the original breeding herd to r turned to Vaughan. Vaughan had accepted them as replacement r reeding stock and sold them only because they had no facil- ie for caring for all of their breeding herd. The 170 heifers er 12 months old were sold to Milford for the same reason. en if petitioner admits, arguendo, that heifers sold in the ar 1948, 1949 and 1950 were not held primarily as members of e reeding herd but were held for sale to customers in the ordin- y ourse of their trade or business, it is respectfully sub- ttd to this Court that it simply is not true that the conditions ev iling in 1951 were the same as those existing in prior years. it obviously, if any heifers sold April 1, 1951 were held for le they would have been sold in the fall of 1950 when they re in the best shape to be sold as beef and not carried through e inter on a feed lot.

The Tax Court made the following finding of fact, which is pl supported by evidence produced at the trial, that:

> "At the termination of the contract in 1951, the Vaughan partnership did not have available facilities sufficient to accommodate all of the animals to which it was entitled. Certain range lands had been leased in Oregon to accommodate some of the animals; but despite a 2-year search, the partnership had been unable to locate satisfactory facilities to which to remove the entire replacement herd and increase for further operation. No agreement could be reached with Milford to continue running some



s quite obvious that the heifer sales in 1951 to Milford and esale of heifers to Robert Vaughan in that same year was a rial liquidation of the Vaughan breeding herd. In the year 5 Vaughan was entitled to receive 1,520 cattle plus one-half he increase of 220, or 1,630 head of cattle. Vaughan's sales ci that breeding herd in 1951 were:

	Cows	Heifers	Bulls
To Milford	400	50 170	22
To Barlow	202		
To Robert Vaughan	____	60	___
Total	602	280	22

eremaining herd was disposed of and the partnership liquidated 952 (R. 252).

The Commissioner of Internal Revenue subbornly resisted etreatment of gains from the sale of livestock as capital i from the time of the addition of Section 117(j) to the ternal Revenue Code of 1939 in 1942. However, despite this sstance, the Commissioner did recognize as early as 1945 that i realized on breeding animals in partial or complete liquida- ci of a breeding herd constituted capital gain. I. T. 3712, 5 C.B. 176, states in part:

> "I. T. 3666, supra, recognizes that the ordinary sales of livestock by a livestock raiser are productive of ordinary income, and abnormal sales which effect a reduction in the breeding herd are subject to the provisions of section 117(j) of the Code."

In I. T. 3712, 1945 C.B. 176, 177, the Commissioner of ernal Revenue described a situation that is precisely the same

he situation with respect to 230 heifers in this matter and

ld that the sale of yearling heifers held through the winter

al be presumed to be held for breeding purposes. I.T. 3712,

pa, provides in part:

> "Immature animals which have been retained by a livestock raiser for breeding purposes shall be considered a part of the breeding herd. Gains and losses from normal sales of such immature animals, however, in accordance with the foregoing principles, are not subject to the provisions of section 117(j) of the Code. Ewe lambs and heifer yearlings held through the winter shall be presumed to be held for breeding purposes. Heifer calves shall be considered to be held for breeding purposes if and to the extent that the livestock raiser normally keeps such heifer calves for breeding purposes." (Emphasis supplied)

Basic, fundamental common sense tells us that in order to

e preserve a breeding herd at a given size, sufficient two-

a old heifers and yearling heifers (those just over a year

d must be retained in order to have ordinary replacements in

efollowing years of the cows that die and those that are culled

o the herd because of disease, injury, lack of milk, failure to

ed, and similar causes. Despite the fact that Vaughan was

red to sell every heifer they owned up through the age of 2

as, leaving absolutely none as ordinary replacements let alone

yto increase the herd, the respondent's position that these

ials were not part of the breeding herd was sustained by the

xCourt. It is evident that the respondent in taking his position

his matter has completely ignored his position in I. T. 3712,

4 C.B., 176, wherein a test to be used under the identical

umstances present here was prescribed as follows:

"Since in many cases it will be found impractical to determine accurately the number of animals sold from the breeding herd, the following prima facie test is provided for the guidance of livestock raisers. If the number of animals sold from the breeding herd during a taxable year exceeds the number of raised animals added to the breeding herd during the same year, it will be presumed that the excess number sold consisted of animals held for breeding purposes, the gain or loss from which (if held for more than six months) is subject to the provisions of section 117(j) of the Code. Such sales effect a reduction in the livestock raiser's breeding herd."

I. T. 3712, supra, represented the Commissioner's position ring the years 1945 through 1950. In essence, the Commissioner ld that culls did not produce capital gain but partial liquida- on of a breeding herd did qualify. In 1951, I. T. 3712 was voked by Mim. 6660, 1951-2 C.B. 60, wherein the Commissioner of ternal Revenue noted the decisions in the Albright and Bennett ses, heretofore discussed under part I, and ruled that taxpayers uld be entitled to capital gain if the breeding animals had en used for substantially their full period of usefulness. The sition stated in Mim. 6660 was withdrawn in Mim. 6776, 1952-1 B, 71, issued after Section 324 of the Revenue Act of 1951 ended Section 117(j) of the 1939 Code to explicitly and absolutely ver livestock held for draft, breeding, or dairy purposes.

Certain principals advocated by the Commissioner of Internal venue in I. T. 3712 were repudiated by the courts and by the ngress in amending Section 117(j) regarding cattle. The Committee ports reflect the liberalization intended by Congress in deter- ining which animals were held as breeding stock. However, even ough the Commissioner of Internal Revenue revoked I. T. 3712

or issuance of Mim. 6660 wherein he liberalized his view regard-g reeding livestock, there is not one word uttered in Mim. 6660, 1ter publications, wherein the Commissioner of Internal Revenue ve'sed his early position stated in I. T. 3712, supra, that gains aimals sold in reduction or liquidation of a breeding herd sut in capital gain. Nor was there any indication of a position arge that if heifer yearlings are carried through the winter and er sold it is presumed the animals sold were breeding animals. es views reflected actual realities in the industry, to-wit, a animal was intended for sale as beef, it would be sold at a me when the animal was in the best condition and it would not carried through the winter on feed and then sold. Even though T 3712 was later revoked, successive rulings liberalized the mmssioner's views stated in I. T. 3712 rather than further strict capital gains on livestock held for breeding purposes.

If we apply the formula set forth in I. T. 3712 as a prima c test, there can be no question but that Vaughan is entitled apital gains on heifers sold in 1951. The whole breeding herd s liquidated and sold by Vaughan in 1951 and 1952 (R. 252).

The decision of the Tax Court that the situation in 1951 s not any different than that which existed in 1948, 1949 and 15 simply is not supported by the facts in the record. Their cision is in contradiction of their own findings that the situ-ion was changed in 1951, and finds absolutely no support in the cord of this case, nor in Section 117(j), Internal Revenue Code 939, the history of that section, or the cases decided there-der. The position of the respondent and the decision of the

x ;ourt in this case represents a retrogression even beyond the mmissioner's original position of 20 years ago that the sale of iers does not result in capital gains unless the herd is qidated.

There can be no disagreement here as to the facts. Vaughan d no place to care for the cattle and their breeding herd was qidated. This was done on a piecemeal basis but it was never-eess liquidated and the whole partnership passed out of exist-ce in 1952. The heifers sold were held for more than 12 months iarily for breeding purposes. In view of the history of this cion of the Code, the amendment in 1951 to codify the expressed tnt of Congress to overrule the position of the Commissioner nternal Revenue, and the case law interpreting the section, s submitted that the decision of the Tax Court with respect 951 is completely erroneous because it is not supported by y evidence at all and should be reversed.

If there was ever any question of the intent of Congress llow capital gain on the sale of livestock held for breeding roses, the answer has been supplied in the addition of Section 4 to the Internal Revenue Code of 1954 in 1962. This section qires gain on sale of depreciable property to be reported as dnary income, except to the extent that the selling price ceds original cost price. Section 1245 is expressly made picable to all depreciable assets listed in Section 1231, trnal Revenue Code of 1954 (successor to Section 117(j), trnal Revenue Code of 1939) <u>except</u> livestock. Gain on live-ok held primarily for breeding purposes still results in

pital gain, whereas gain on sale of other depreciable assets ed in trade or business is to be taxed as ordinary income in e future.

Respectfully submitted,

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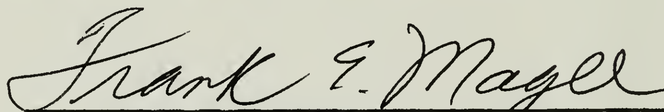
I certify that, in connection with the preparation of this if, I have examined Rules 18 and 19 of the United States Court ppeals for the Ninth Circuit, and that, in my opinion, the rgoing brief is in full compliance with those rules.



Frank E. Magee, Attorney